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IN THE

Supreme Court of the United States

October Term, 1955

No. 393

GEORGE BERNSTEIN, et als,

Petitioners,

versus

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

May it Please This Honorable Court

Petitioners pray that a Writ of Certiorari issue to review the Judgment of the United States Court of Appeals for the Fifth Circuit.

OPINION BELOW

The District Court wrote no opinion. The opinion of the Court of Appeals (Appendix, Page 1a) is reported at 234 F. 2d 475.

JURISDICTION

The judgment of the Court of Appeals was entered on May 31, 1956. Petition for Rehearing was filed within the

time allowed by the court in its Order dated June 14, 1956, (R. 1321) which Petition was denied on August 7, 1956. The jurisdiction of this Honorable Court is invoked under Title 28 U.S.C., 1254.

QUESTIONS PRESENTED FOR REVIEW

I

Where, by indictment and bill of particulars, petitioners were accused of attempted individual income tax evasion for failure to report certain "dividends", could petitioners be convicted where, under applicable laws, the Government failed to prove the existence (and petitioners were not allowed to show the non-existence) of any accumulated or current earnings or profits of the corporation out of which dividends could be paid?

II

Where petitioners' counsel had three times made known his desire to take exceptions to the trial court's instructions, was it not prejudicial error for the trial court, (1) not to afford counsel an opportunity to make such exceptions out of the hearing of the jury, and (2) not to permit counsel the right fully to state the basis of his objections, before the jury retired?

III

Where petitioners were charged with wilful tax evasion, was it not error for the trial court to charge that criminal intent might be presumed from their acts?

STATUTES INVOLVED IN QUESTION I.

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) General Definition. — "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(e) Distribution by Corporations.—Distribution by corporations shall be taxable to the shareholders as provided in section 115.

(26 U.S.C. 1946 ed., Sec. 22.)

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) Definition of Dividend. — The term "dividend" when used in this chapter * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or

profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made. * * *

(b) Source of Distribution.—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. * * *

* * * * *

(d) Other Distributions from Capital.—If any distribution made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not a dividend, then the amount of such distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property. * * *

(26 U.S.C. 1946 ed., Sec. 115).

SEC. 145. PENALTIES.

* * * * *

(b) Failure to Collect and Pay Over Tax, or Attempt to Defeat or Evade Tax.—Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who wilfully fails to collect or truthfully account for and pay over such tax, and any person who wilfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with costs of prosecution.

(26 U.S.C. 1946 ed., Sec. 145.)

STATUTES INVOLVED IN QUESTION II.

Rule 30, Federal Rules of Criminal Procedure

Instructions

At the close of the evidence or at such earlier time during the trial as the court reasonably directs, any party may file written requests that the court instruct the jury on the law as set forth in the requests. At the same time copies of such requests shall be furnished to adverse parties. The court shall inform counsel of its proposed action upon the requests prior to their arguments to the jury, but the court shall instruct the jury after the arguments are completed. No party may assign as error any portion of the charge or omis-

sion therefrom unless he objects thereto before the jury retires to consider its verdict, stating distinctly the matter to which he objects and the grounds of his objection. Opportunity shall be given to make the objection out of the hearing of the jury.

(FEDERAL RULES OF CRIMINAL PROCEDURE, TITLE 18 U.S.C.)

STATEMENT

On January 27, 1954, George Bernstein, David Scherer, Ben Hammerman, Barney Hodes and Charles Gersch were indicted on 14 separate counts of income tax evasion and conspiracy. Petitioners Bernstein, Scherer, Hammerman and Hodes were each charged in three-count indictments (R. 1, 56, 117, 130) with wilfully having attempted to defeat and evade his individual income taxes for the years 1947, 1948, and 1949, inclusive. In addition, each of the foregoing petitioners was charged in a separate three-count indictment (R. 104) with having wilfully atempted to evade and defeat the income taxes of a certain Florida corporation, to wit: the Selray Corporation, for the fiscal years ending October 31, 1947, 1948, and 1949. Petitioner Gersch was charged in a separate indictment with aiding and abetting the other-named petitioners in an attempt to defeat and evade the income taxes of the Selray Corporation; and in addition, all of the petitioners (R. 73) were charged in another indictment with conspiracy to defeat and evade the income taxes of the said Selray Corporation for the fiscal years 1947, 1948, and 1949.

After jury trial, all petitioners were found guilty on

all counts. Petitioners were sentenced to concurrent terms of imprisonment on each count, and in addition varying fines were imposed on the individual counts (R. 30, 71, 83, 85, 86, 88, 90, 110, 112, 114, 115, 128, and 145).

In each of the four indictments for individual income tax evasion, the respondent had been ordered to furnish bills of particulars, which, in answer to a request to state whether or not each individual petitioner was charged by the respondent with having received unreported income, particularized as follows:

> * * * and that the amounts in the following schedule which were omitted from the returns filed by the defendant were actually received by the defendant: * * *
>
> | | 1947 | 1948 | 1949 |
> |---|---|---|---|
> | Dividends— | | | |
> | Selray Corp. | $15,086.67 | $8,440.45 | $4,346.21 |
>
> * * * (R. 13)

The evidence of unreported income upon which the petitioners were convicted may be summarized as follows: The Selray Corporation during the years involved was the operator of a hotel located in Miami Beach, Florida. The petitioners, with the exception of Gersch, were equal stockholders in such corporation. The books of the corporation were set up upon the accrual basis.

Government Agent Karo, one of the respondent's witnesses, testified that he had audited the records of the Selray Corporation for certain selected months within each of the fiscal years involved, and had found that the totals of certain "duplicate guest bills" of the hotel for those

months were in excess of the totals shown on the hotel books for the same months. This witness then asserted that this excess represented additional income to the corporation. He set up the total amount of what he considered additional income to the Selray Corporation for each of the calendar years 1947, 1948, and 1949, divided this total by four, and added the resulting amount to the reported net income of each of the individual petitioners for the years charged (R. 848-860); the witness assuming these amounts to be "dividends" as charged in the bill of particulars.

Petitioners' counsel immediately objected to the testimony on the ground that no earnings or profits, and hence no "dividends" had been shown. The trial court overruled this objection, holding that no earned surplus need be shown (R. 853-854) since dividends could be paid "legally or illegally". In this same connection, however, the trial court refused to admit into evidence a Government exhibit (No. 71 for Id.) purporting to show a computation of earned surplus (upon the respondent's theory of how it should be done) upon petitioners' objection that there had been no foundation laid for the matters contained in such exhibit (R. 850-857 Appendix page 26). On cross-examination by petitioners' counsel, this witness testified that he had "made a determination" of earned surplus, but the petitioners' counsel was not permitted to cross-examine this witness as to the basis of his computations (R. 898-900, 903-905).

In presenting their case, the petitioners attempted to show that there were *no* current or accumulated earnings or profits, out of which the dividends, charged to the individual petitioners by the bill of particulars, could be paid. Petitioners offered testimony showing the amount of addi-

tional taxes and profits of the Selray Corporation which had been proposed to the corporation's representative by members of the Internal Revenue Service. This testimony and a schedule summarizing it (Def. Ex. 1 for Id.) was excluded from evidence by the trial court on the grounds of materiality (R. 1069-1071). Subsequently, petitioners proffered witness Kantzler, a Certified Public Accountant. Based upon the trial court's advance indication that his testimony would not be admitted, his witness was qualified as an expert out of the presence of the jury. Continuing in the absence of the jury, petitioners proffered this witness' testimony that, contrary to that which had been testified to by the Government witness (R. 904), and contrary to the trial court's understanding (R. 918), actually there was no earned surplus from which taxable dividends might be paid. This testimony was incorporated into a schedule prepared by this witness (Def. Ex. 17 for Id.). Neither the testimony of this witness nor the exhibit was allowed into evidence (R. 1206), the trial court holding it immaterial. At the close of all the evidence, petitioners moved for judgment of acquittal in each of the individual cases for the reason that no earnings or surplus was shown to have been available out of which the unreported dividends, charged by the indictment and the bill of particulars, could have been paid (R. 1219-1220). These motions were denied as to each petitioner.

With respect to the Second Question urged herein: In its charge to the jury, the trial court included the following language:

> The law presumes that every man intends the legitimate consequences of his own acts, and a man is charged with knowledge of that which naturally

and normally from all the evidence flows or results from his acts normally done or performed. (R. 1244)

Passing now to the Third Question: At the conclusion of the trial court's charge, petitioners' counsel attempted to state his objections to the charge in the manner prescribed in Rule 30, Federal Rules of Criminal Procedure, and the following took place:

MR. CUNNINGHAM:
(Trial counsel for petitioners)

If the Court please, I'd like to be heard on certain matters.

THE COURT:

Any more instructions?

MR. CUNNINGHAM:

Instruction No. 8, I think. I don't think you gave that.

[The Court gives additional instructions]

MR. CUNNINGHAM:

I'd like to take exceptions to particular items.

THE COURT:

You may have exception to all instructions that the Court gave.

MR. CUNNINGHAM:

You don't want me to particularize?

THE COURT:

I don't think so. The instructions I gave you have the right to take exception to those, and the ones I didn't give—I think I gave practically all of them.

MR. CUNNINGHAM:

That is correct, Your Honor.

THE COURT:

The ones the Court gave you have the right to take exception to.

MR. CUNNINGHAM:

I want to take exception to the one on intent that you gave.

THE COURT:

All right. You may retire and appoint one of your number as Foreman. The alternates will be excused when the jury retires. Any exhibits the jury want, they may have. How about copies of these indictments? Mr. District Attorney, do you have copies of them?
(R. 1247-1248)

REASONS FOR GRANTING THE WRIT AS TO QUESTION I.

Summary of Reasons

1. **The government, by indictment and bill of particulars, charged the petitioners with having wilfully attempted to evade their income taxes by failing to report "dividends".**

2. **"Dividends", reportable as income, are defined by Statute.**

   (a) **Distributions to a stockholder, out of other than earnings or profits, are not taxable as "dividends".**

   (b) **To determine availability of taxable "dividends" all federal tax liabilities must first be deducted from net profits.**

3. **The Government's evidence failed to show that the Selray Corporation had earnings and profits available for distribution as dividends.**

4. **Petitioners were denied the right to show the Corporation had no earnings or profits out of which to pay "dividends".**

5. **The Court of Appeals in failing to reverse on this ground is in conflict with the applicable decisions of this Court, and has decided a novel and important question of Federal Law in admitted conflict with the Tax Court of the United States.**

Petitioners Bernstein, Scherer, Hammerman, and Hodes were each charged, by separate three-count indictments, with having evaded his individual income taxes for the calendar years 1947, 1948, and 1949. The bills of particulars filed as to each of the above indictments (R. 12, 67, 124, 141) stated, in effect, that each of the above-named petitioners were charged with receiving one item of income which had not been reported, *viz.*, "dividends" from the Selray Corporation in the amount of $15,086.67 in 1947, $8,440.45 in 1948, and $4,346.21 in 1949.

Now, basic to a valid conviction of *any* crime is proof of the corpus delicti. In the case of the felony proscribed by section 145(b) of the Internal Revenue Code of 1939, proof of an understatement of net income is essential—without such understatement there can be no offense. *Smith* v. *United States*, 348 U.S. 147, 154 (1945); *United States* v. *Schenck*, 126 F.2d 702 (C.A. 2, 1946). As in other criminal cases, the prosecution has the burden of proof as to every element of the offense. *Holland* v. *United States*, 348 U.S. 121, 138. Thus, in addition to a wilful intent to defraud, the Government must also prove that the accused owed more income taxes than he paid. *United States* v. *Augustine*, 189 F. 2d 587, 589 (C.A. 3, 1951).

Section 22(a) of the 1939 Code defined "gross income" as including income from "dividends", but adds in Setcion 22(e) that "distributions by corporations shall be taxable to the shareholders as provided in Section 115". Thus, Congress saw fit to qualify the all-encompassing nature of Section 22(a). The Courts have repeatedly recognized this qualification. In other words, Section 115 defines the taxability of "distributions by corporation", *Helvering* v. *Griffiths*, 318 U.S. 371, 394, 37 L. Ed. 843

(1934). A corporate distribution is includable in gross income of the individuals receiving such distribution, under Section 22(a), *only* if it is income under Section 115. See *Commissioner* v. *Goldwyn*, 175 F. 2d 641, 643 (C.A. 9, 1949) and *Jackson* v. *Commissioner*, 172 F. 2d 605, 606 (C.A. 7, 1949).

For the purposes of this question, subsections (a), (b), and (d),of Section 115 of the 1939 Code are all that are required to be considered. Subsection (a) defines a dividend as "any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year." Subsection (b) states that "every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits." Subsection (d) provides that if a distribution "is not a dividend," then the amount of the distribution "shall be applied against and reduce the adjusted basis of the stock"; and if the amount of the distribution exceeds that basis, the excess is "taxable in the same manner as a gain from the sale or exchange of property".[1]

From the foregoing, it is quite apparent that under Section 115 I.R.C. 1939, a distribution from a corporation to a stockholder is taxable as ordinary income *only* if those funds distributed are from the corporation's earnings or profits. It is for this reason that the term "earnings or profits" has "long been in the revenue acts". *Commissioner* v. *Wheeler*, 324 U. S. 542, 545, 89 L. Ed. 1166 (1945).

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1 As section 115(d) indicates, if there are no earnings or profits, a distribution is at most a capital gain after the stockholder recovers the basis of his shares. See, e.g., *Shield Co.*, 2 T.C. 763 (1943). Here the Government treated the distribution as ordinary income.

If a corporation has no earned surplus, the stockholder has no income, as stated by Justice Stone in *Palmer* v. *Commissioner*, 302 U. S. 63, 69 (1937):

> * * * but the bare fact that a transaction * * * has resulted in a distribution of some of the corporate assets to stockholders, gives rise to no inference that the distribution is a *dividend* within the meaning of Section 115.

Therefore, in the case at bar, in which the Government placed upon itself the burden to prove "dividends", as shown by the bills of particulars, it must prove beyond reasonable doubt that the corporation had earnings and profits out of which it could pay such "dividends". Otherwise, the Government fails to establish that a distribution obtained from the corporation is taxable as dividends and ordinary income.

The earnings and profits which are available for distribution as "dividends" are considerably different from the "net earnings" of a corporation. In computing earnings or profits available for distribution as "dividends", for any year, allowance must first be made for Federal and state income taxes, excess profit taxes (if any), and certain other corporate liabilities which are not deductible in computing what is ordinarily termed as "net income". In the case of an accrual basis corporation (as was the Selray Corporation) all Federal income taxes must be deducted for the purpose of determining earnings and profits, and such taxes are deemed to accrue at the end of the year in which all events have occurred which fix the amounts of such taxes and determine the taxpayer's liability there-

for. *United States* v. *Anderson*, 269 U. S. 422, 46 S. Ct. 131, 70 L. Ed. 347; *Fawcus Machine Co.* v. *United States*, 282 U. S. 375, 51 S. Ct. 144, 75 L. Ed. 397; *Rose* v. *Dobbs*, 36 F. 2d 464 (C. A. 5, 1929); *Stern Bros. & Co.*, 16 T. C. 295.

In the case at bar, the petitioners' theory of defense was based upon the above well-established concepts. If the Selray Corporation actually had tax liabilities in excess of the amounts reported in its returns, such excess liabilities would have to be deducted from the net earnings of the corporation before the amount available for distribution as dividends is determinable; and if the petitioners, or either of them, or any of them (assuming the Government's evidence to be true) had received any distribution in excess of the new and lesser amount found to be available for distribution, then any such distribution actually made would, in so far as such distribution exceeded the available amount, (after recovery of the basis of the shares) be at most a return of capital, taxable at capital gain rates.

The petitioners sought by Witness Kantzler and by the exhibit prepared by him (Appendix, page 26 et seq.) to show that, after accruing all of the tax liabilities that the representatives of the Internal Revenue Service had indicated would be assessed against the Selray Corporation, there would be a net loss for each of the three fiscal years, and no dividends could possibly have been paid. Hence, even if the petitioners had received distributions in the amounts claimed by the respondent, such distributions were not taxable as ordinary income. In other words, whatever the petitioners might be guilty of, they were not guilty of evasion of individual income taxes, because in many

cases no tax was due. (See, e. g., Count Three of the indictment of Petitioner Bernstein (R. 3).

When this question was first raised in the trial court it was attended by confusion. The trial court was of the opinion that no earned surplus need be shown (R. 853), since "dividends" could be paid "legally or illegally".[1] Accordingly, the trial court refused to admit the Government Agent's computation of earned surplus on the ground (among others) that no proper foundation had been laid (R. 850-857). Based further upon the trial court's theory that earned surplus need not be shown, petitioners counsel was not allowed to cross-examine this witness as to his method of computing earned surplus (R. 898-900, 904, 918).

Notwithstanding the trial court's theory, the Government Agent did make the bare statement that he had considered earnings and profits in charging the petitioners with receipt of "dividends". Petitioners tried to refute the Government witness' statement that he had considered earnings and profits, but the trial court stood upon his original theory and refused this proffered evidence on the grounds of "materiality". (See Statement of Facts, Page 9).

The Court of Appeals excused without comment this error of the trial court on the grounds that petitioners "lay entirely too much stress upon the technical requirements

[1] MR. CUNNINGHAM: * * * It is my theory here that we cannot have a corpus delicti if there is no earned surplus from which these dividends could accrue.
THE COURT: No. I cannot go along with you on that at all. You may argue that at some higher Court. I am going to reserve ruling on that question until somebody shows me some authorities. It is a very nice question of law. (R. 853-854).

as to the declaration of dividends." (Appendix, Page 10a). Nevertheless, the Court of Appeals well knew that the trial court was in error since the opinion recognizes the necessity for showing earned surplus in order to charge the petitioners with the receipt of dividends (Appendix, page 11a).

The Court of Appeals justifies the trial court's refusal to allow the petitioners to show their defense by holding that it was proper to first deduct the additional taxes (Appendix, Page 7a) but *refused* to hold that penalties, both delinquent and fraud, were similarly chargable against earnings and profits before determining amounts available for distribution as dividends.

The Court of Appeals, in order to hold thus, was required squarely to oppose the careful reasoning of the Tax Court of the United States in the only other reported case precisely on the point. *Esther M. Stein*, 25 T. C. _____ (No. 109). The Court of Appeals expressly rejects the decision (Appendix, page 12a).

Obviously, either the Tax Court or the Court of Appeals is in error. The petitioners submit that the Tax Court, correctly answers this important question of Federal Law. The Court of Appeals cites no authority whatever for its position, but appears to place great importance on the fact that no formal additional assessment had been made. This portion of its opinion is in direct conflict with this Court's decision in the case of *Fawcus Machine Company* v. *United States, supra*, wherein it was held that for the purpose of determining earnings and profits of an accrual basis corporation, certain taxes must be deducted (from net earnings in a given year) even

though the law establishing the rate of taxation had not yet been enacted. It is submitted that any additional taxes and penalties assessable against the Corporation for the year in which the return is filed must likewise be deducted before determining available earnings and profits.

The *Esther M. Stein* case, *supra.*, so holds.

The petitioners respectfully submit that this question is entitled to Supreme Court review. The real issue is whether, where Congress has laid down the law respecting the taxability of income, and the courts have rendered decisions interpreting this law, the Government may devise special laws in criminal prosecutions. In prosecutions the statutes should be strictly construed. In the case at bar, loose construction has permited conviction of a crime where under the true interpretation of the law, probably no crime has been comitted. No man can be guilty of theft of his own property, nor guilty of attempted murder of a corpse. Manifestly, a man cannot be guilty of tax evasion of ordinary income if the distribution received is not taxable as ordinary income.

This question calls for an exercise of this Court's powers of supervision. Unless such supervision is considered we will continue to have diverse concepts of income for civil and criminal purposes. The decision of the Court of Appeals will inevitably imperil the rule that dividends are founded on corporate earnings and profits. The need for supervision is further evidenced by the irreconcilable conflicts of the Courts of Appeals in this whole general area.

In the case of *Currier* v. *United States*, 166 F. 2d 346

(C. A. 1, 1948) the court held that a sole stockholder appropriating funds from a corporation was chargeable with omitting income *equal only* to the earned surplus available. In the recent case of *Dix* v. *Commissioner*, 223 F. 2d 436 (C. A. 2, 1955) Cert. Den. 350 U. S. 894, the Second Circuit held that money wrongfully appropriated by the president of a closely held family corporation did not constitute income to the person appropriating following the rule in *Commissioner* v.*Wilcox*, 327 U. S. 404. On the other hand, the recent case of *Poncet Davis* v. *United States*, 226 F. 2d 331 (C. A. 6, 1955), Cert. Den. 350 U. S. 965, held that no earned surplus need be shown in order to charge a sole stockholder with ordinary income on moneys received from a corporation. In the case at bar the Court of Appeals rejected the reasoning of the *Poncet Davis* case, but refused to follow the *Esther M. Stein* case, Supra, thus suspending itself in mid-air between the current decisions.

It is submited that Congressional enactments should and must have equal applicability to the Government and its citizens.

REASONS FOR GRANTING THE WRIT AS TO QUESTION II

Summary of Reasons

1. **The Court of Appeals admits that undesirable instructions, as to presumptive intent and reasonable doubt, were given. (Appendix, Page 15a and 22a).**

2. **The petitioners' counsel was denied the opportunity to object to these instructions out of the hearing of the jury.**

3. **When petitioners' counsel then tried to state his objections in the presence of the jury, he was cut off by the trial court without being allowed fully to state the basis for his objections.**

4. **In failing to reverse for these reasons, The Court of Appeals is in conflict with the Court of Appeals for the Fourth Circuit, the Court of Appeals for the District of Columbia, and inferentially at odds with this Court.**

The portions of the trial court's charge of which the petitioners complained in the Court of Appeals were not included in the requests made by the respondent, and were not made known to petitioners' counsel until such time as actually given to the jury. Thus, there was obviously no opportunity for petitioners' counsel to make his objections to the instructions as given until *after* the completion thereof. The error which petitioners urged in the court below grows out of the events transpiring at the conclusion of the trial court's charge. The record shows that the charge was concluded at 6:15 p.m., and immediately thereafter petitioners' counsel rose and, as petitioners urged in the Court of Appeals, made an obvious request for a hearing on his objections (R. 1247) although, speaking as he was *in the presence of the jury*, couched his request to avoid using the words "out of the presence of the jury". The trial court apparently did not recognize this request for what it was; he asked if there were any more instructions, and gave one request that had been omitted. Then, counsel again tried to apprise the court of his purpose:

MR. CUNNINGHAM:

I'd like to take exceptions to particular items. (R. 1247)

Instead of granting a hearing, the trial court, *still in front of the jury*, said:

You may have exception to all instructions the court gave. (R. 1248)

Then counsel attempted to particularize his objetcions in the presence of the jury. The trial court informed counsel that he did not desire him to particularize and when counsel did so attempt, the trial court ignored counsel and sent the jury out (R. 1248). An hour and one half later the jury returned for additional instructions.

The reason petitioners ask Supreme Court review of this question is the urgent necessity of resolving conflicting interpretations of the meaning of the last sentence of Rule 30, Federal Rules of Criminal Procedure:

Opportunity shall be given to make the objections out of the hearing of the jury.

From the language in which this rule is stated, it would appear that this requirement is mandatory, and not merely optional with the courts. "The word 'shall' is ordinarily 'the language of command', *Escoe* v. *Zerbst*, 295 U. S. 490, 493; 55 S. Ct. 818, 819; 79 L. Ed. 1566. And when the same Rule uses both 'may' and 'shall', the normal inference is that each is used in its usual sense—the one act being persuasive, the other mandatory." *Anderson* v.

Yungkow, 329 U. S. 482, 485; 67 S. Ct. 428, 430; 91 L. Ed. 436.

In the case of *Lovely* v. *United States*, 169 F. 2d 386 (C. A. 4 1948), while reversing on another ground, Judge Parker said the following regarding the mandatory requirement imposed on the courts by Rule 30:

> * * * We note that the exceptions to the charge were not made in the absence of the jury as the law contemplates. Federal Rules of Criminal Procedure, rule 30, 18 U. S. C. A. following section 687. *Ordinarily, failure to observe the requirements of this rule will be held sufficient ground for granting a new trial, unless it affirmatively appears that no prejudice resulted therefrom;* for counsel should not be required in the presence of the jury to place themselves in the attitude of apparent antagonism to the trial judge which is involved in excepting to the charge. Since we are granting a new trial upon other grounds, however, it is not necessary that we make any ruling upon the matter here. We mention it to call attention to *our view that the requirements of the rule, which was adopted after most careful consideration must* be strictly observed. (Emphasis supplied) 169 F. 2d 386, 391.

Although the Fifth Circuit has, in a recent decision, *Schaffer* v. *United States*, 221 F.2d 17 (C. A. 5 1955) cited the above language with approval, in the case at bar this same Court of Appeals held that the *Lovely* case did not apply (Appendix, Page 14a). Thus, in the face of the factual situation set out herein, the court below made an

inferential finding not only that the trial court need not honor the seeming mandate of Rule 30, F. R. Cr. P., but also that the failure was cured because "the jury was twice instructed after first retiring".

Petitioners submit that this question deserves expeditious review by this Tribunal. On the one hand is Judge Parker's statement of the Fourth Circuit's view that the requirement of the rule must be "strictly observed" and that failure to do so is ordinarily "sufficient ground for granting a new trial"; and on the other hand is the opinion of the Court of Appeals in the case at bar that "If the Court please, I'd like to be heard on certain matters." and "I'd like to take exceptions to particular items." and "You don't want me to particularize?" and "I want to take exception to the one on intent that you gave." (R. 1247, 1248) do not constitute an adequate request to the trial court to observe his duty under the rule, and that "failure to excuse the jury *sua sponte* to invite objections was not error." (Appendix, Page 14a).

Here, counsel was caught between the necessity of preserving the record, and the danger (soon realized) that the trial court would indicate to the jury that counsel took exception to *all* of the court's instructions (R. 1248).

Furthermore, the decision of the Court of Appeals that there was no error in the trial court's failure to allow petitioners' counsel fully to particularize his objections, and that any failures were cured because the jury later returned for further instructions, is in conflict with the decision of the Court of Appeals for the District of Columbia in *Butler* v. *United States*, 188 F. 2d 24 (C. A. D. C. 1951). In this last-named case, the court found reversible

error in the failure of the trial court to allow contemporaneous full objections to the manner of giving instructions, the decision being based not upon Rule 30, but upon general principles for the conduct of a trial:

> We hold that the action of the trial court, in denying appellant the opportunity fully to state the basis of his objection to the court's charge before the jury left the room, is not the sort of error the correction of which is contemplated by the rules. *On the contrary, it constitutes error affecting a defendant's substantial right to a fair trial and requires remanding the case for a new trial.* (Emphasis supplied) 188 F. 2d 24, 27.

Petitioners submit that the answer to this question involves a basic and compellingly important concept: to what extent may a procedural rule stated in the language of command be disregarded by the trial court? The finding of the Court of Appeals that no request was made for the hearing provided for by the rule seems, to petitioners' counsel, in the light of the cited portions of the record, palpably erroneous. Indeed, had counsel added something like "I don't want the jury to hear this", it would have brought about the very evil that the rule was designed to prevent! But assuming *arguendo* that the request was not made with sufficient clarity, the question still calls urgently for answer by the Court. The Circuits appear to be in irreconcilable conflict as to the mandatory observance of this rule. The case of *Lovely* v. *United States*, *Supra.*, holds that error results where the exceptions "were not made in the absence of this jury as the law contemplates", and makes no mention of the necessity of a request in any given language. On the other hand, the opin-

ion of the Court of Appeals for the Fifth Circuit in the case at bar, as well as that of the Second Circuit in the case of *United States* v. *Hall*, 200 F.2d 957 (C. A. 2 1953) holds that either no error or harmless error results from a similar situation.

In a broader sense, the decision in the case at bar is in conflict with the opinion in the case of *Escoe* v. *Zerbst*, 295 U. S. 490; 55 S. Ct. 818; 79 L. Ed. 1566, wherein this court speaking through Mr. Justice Cardozo set forth the principle that a statute designed to protect the rights of an accused may not be disregarded where such statute is in mandatory language. It is submitted that the language of rules promulgated by this court should not be given a lesser value. The Court of Appeals unquestionably admits that certain undesirable instructions were given. (Appendix, Pages 15a, 21a, and 22a). Had the rule been observed, these improper portions of the charge probably would have been withdrawn, and there would not be the perpetual riddle as to whether the proper instructions corrected the improper. Under these circumstances, how can it be said that the petitioners were not prejudiced by the failure of the trial court to afford them the hearing made mandatory by the rules?

The answer to this question is of great importance in the administration of criminal justice in the Federal Courts. Every single criminal jury case hereafter to be tried in the District Courts of the United States must, of necessity, be governed by the rule in question. The Circuits are in conflict as to the real need for observing this rule, and whether or not non-observance is harmless to the accused. From the point of view of legal equaminity, the opinion of the Court of Appeals is in conflict with the deci-

sions of this Court regarding the duty of courts to observe mandatory rules, e. g. *Escoe* v. *Zerbst, Supra,* and *Anderson* v. *Yungkow, Supra.* Failure to observe this rule may well be a denial of procedural due process guaranteed by Amendment V of the Constitution. Petitioners respectfully submit that the final definitive word should be spoken by this Court.

REASONS FOR GRANTING THE WRIT AS TO QUESTION III

Summary of Reasons

1. **Petitioners were charged with wilfully attempting to evade income taxes.**

2. **Specific intent is an element of the offense charged.**

3. **The trial court instructed that intent might be presumed from petitioners' acts.**

4. **The Court of Appeals held**

   (a) **That the instruction was not reversible error, although undesirable.**

   (b) **That the instruction was corrected by other charges given.**

5. **In so deciding, the Court of Appeals is in conflict with applicable decisions of this Court, of other Courts of Appeals, and of its own prior decisions.**

An essential element of the felony proscribed by Section 145(b) of the 1939 Internal Code, under which petitioners were indicted, is a specific wrongful intent. This specific intent must include an evil motive or bad purpose, as opposed to merely a conclusion intent to do the act charged. *United States* v. *Murdock*, 290 U. S. 389, 54 S. Ct. 223, 78 L. Ed. 381; *Haigler* v. *United States*, 184 F.2d 284 (C. A. 1, 1951). See *Spies* v. *United States*, 317 U. S. 492, 63 S. Ct. 364, 87 L. Ed. 418 (1943). This specific wrongful intent must be found by the jury or they are not authorized to convict the accused; neither can it be inferred from the mere understatement of income. *Holland* v. *United States*, 348 U. S. 121, 139; 75 S. Ct. 127; 99 L. Ed. 150, 166 (1954).

Giving instructions to the jury for the determination of criminal intent, the trial court in the case at bar charged as follows:

> Now intent may be ascertained from all the facts in evidence and the inferences that reasonable men might naturally draw from the evidence. *The law presumes that every man intends the legitimate consequences of his own acts*, and a man *is charged with knowledge* of that which naturally and normally from all the evidence flows or results from his acts normally done or performed. (Emphasis supplied) (R. 1244).

In the Court of Appeals the petitioners contended that this charge was prejudicial and reversible error, because said charge was in conflict with the presumption of innocence. It was urged that this instruction was not essentially distinguishable from the type of instruction

condemned by this Court in *Morisette* v. *United States*, 342 U. S. 246, 72 S. Ct. 240, 96 L. Ed. 288 (1952). It was further urged that this instruction was basically the same instruction which this same Court of Appeals, following the *Morisette* case, had declared to be reversible error in trials for the offense of income tax evasion: *Wardlaw* v. *United States* 203 F. 2d 884, (C. A. 5, 1953); *Berkovitz* v. *United States*, 213 F. 2d 468 (C. A. 5, 1954); *Vloutis* v. *United States*, 219 F. 2d 782 (C. A. 5, 1955); *Dupree* v. *United States*, 218 F. 2d 781 (C. A. 5, 1955; see also *Barfield* v. *United States*, 229 F. 2d 936 (C. A. 5, 1956).

In spite of the Court of Appeals' previous consistency of decisions on this point, the case at bar represents a sudden, (and, to the petitioners) inexplicable reversal of precedent. Although the Court of Appeals admits that this instruction represents "The most serious challenge to the judgment of conviction" (Appendix, Page 14a), it attempts to distinguish the case at bar solely because of the trial court's use of one word: "legitimate". In other words, the Court of Appeals holds that

> "The law presumes that every man intends the legitimate consequences of his own acts * * *"

is distinquishable from

> "The presumption is that a person intends the natural consequences of his acts".
>
> [Found to be error in *Wardlaw* and *Berkowitz supra.*]

The Court of Appeals further held that the charge, if error, was corrected by other portions of the charge given (Appendix, 20a).

It is submitted that this decision is in such conflict with applicable decisions of this Court and with the Court of Appeals' own prior decision as to justify the exercise of this Court's power of certiorari. To allow this decision to stand throws into confusion and uncertainty a fundamental and far-reaching principle of Federal criminal law which had previously been settled by this Court's decision in *Morisette* v. *United States*, supra.

The *Morisette* case held that in the trial of a crime requiring proof of intent it was error for the trial court to charge that intent might be *presumed* from other acts. Yet, if one looks to what the Court of Appeals *does* in the case at bar, rather than what it says, the decision can have no other effect than that of denying the *Morisette* principle. It seems obvious to petitioners that the word "legitimate" was used by the trial court and understood by the jury as a synonym for "natural and probable", in accordance with common and accepted usage.[3]

No Court of Appeals could say with certainty that the jurors did not understand and interpret it that way. As Justice Jackson said in the *Morisette* case, "juries are not bound by what seems inescapable logic to judges" (342

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[3] In Webster's New International Dictionary of the English Language, Second Edition, 1953, page 1314, one of the meanings given to the word *legitimate* is the following: "5. Reasonable; to be expected; as a legitimate result." In Funk & Wagnalls New Practical Standard Dictionary, Volume I: "(4) Following in regular sequence; logically deduced."
In the case of *Reese v. Bates*, 94 Va. 321; 26 S.E. 865, 870, the equivalence of this usage is interpreted by a Court: "The objection is directed to he use of the word 'naturally'. We think it is but the equivalent of 'legitimately' 'normally', or, in other words, embraces such damages as are the natural—that is to say, the legitimate, normal result consequent upon the breach of warranty."
In the case of Re: *Little's Estate*, 46 Cal. App. 776; 189 Pac. 818: "By 'legitimate inferences' are meant those inferences that necessarily follow from certain evidence — legal inferences, that are reasonable and legally to be drawn from the evidence."
See also *United States v. Schenck*, 126 Fed. 2d, 702.

U. S. 276). With all respect to the Court of Appeals petitioners submit that words retain their usual meaning to lay-minded jurors regardless of what the Court of Appeals says the word meant.[4]

The Court of Appeals in holding that other instructions given cured any prejudicial effect this charge of presumptive intent may have had, is squarely at odds with the holding of the Court of Appeals of the Third Circuit in the income tax case of *Nicola* v. *United States*, 72 F. 2d 780, 787 (C. A. 3, 1934), wherein the Court said:

> Where two instructions are given to the jury, one erroneous and prejudicial and the other correct, it is impossible to tell which one the jury followed and it constitutes reversible error.

as well as the Court of Appeals of the Tenth Circuit in *Frank* v. *United States*, 220 F. 2d 559, 565 (C. A. 10, 1955), and the Court of Appeals for the District of Columbia in *McFarland* v. *United States*, 174 F. 2d 538, 539 (C. A. D. C., 1949). It is equally at odds with *Bollenbach* v. *United States*, 326 U. S. 607, 612; 66 S. Ct. 402; 90 L. Ed. 350, 354.

The petitioners assert that it is even less likely that the erroneous instruction was cured in the case at bar in view of the fact that the previous correct instructions on intent were labeled by the trial court as "defendants' instructions" (R. 1234, 1235, 1236, 1243).

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[4] " 'When I use a word,' Humpty Dumpty said, in a rather scornful tone, it means just what I choose it to mean — neither more or less.'

" 'The question is,' said Alice, 'whether you can make words mean so many different things.' "

—Carroll, Lewis, *Through the Looking Glass and What Alice Found There*, Chapter 6, page 112, Heritage Press, New York.

In spite of this Court's previous pronouncements, the law at the present time does not appear to be clear to the various Circuits—as to what extent a charge of presumptive intent is permissible in the trial of persons accused of income tax evasion. Unless this question is setled there will continue to be conflicts between the Circuits, and within the Circuits, e. g., the case at bar and the previous decisions of the Fifth Circuit; the apparent conflict in the Ninth Circuit between the cases of *Bloch* v. *United States*, 221 F. 2d 786 (C. A. 9, 1955), affirmed on rehearing 223 F. 2d 297, and the case of *Legatos* v. *United States*, 222 F. 2d 678.

Apparently however, this principle presented no conflict to the trial court. He would not even hear the objections petitioners' counsel tried to make to this charge. (See Question II, Supra.)

CONCLUSION

For all of the three above and foregoing reasons, it is respectfully submited that this Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

CLAUDE PEPPER
ARTHUR B. CUNNINGHAM
PHILIP T. WEINSTEIN
Attorneys for Petitioners

August, 1956

(Appendices "A" and "B" Follow)

PROOF OF SERVICE

The undersigned, of counsel for the petitioners in the within Petition for Certiorari, hereby certify that four copies of the above and foregoing Petition for Writ of Certiorari has been served upon the Honorable J. Lee Rankin, Solicitor General of the United States, Department of Justice, Washington 25, D. C., and upon Honorable James L. Guilmartin, United States Attorney, Post Office Building, Miami, Florida, this _____ day of September, 1956.

_____

(APPENDIX "A")

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 16463

GEORGE BERNSTEIN, ET AL,
Appellants,

versus

UNITED STATES OF AMERICA,
Appellee.

Appeal from the United States District Court for the Southern District of Florida.

(May 31, 1956)

Before RIVES, TUTTLE and JONES, Circuit Judges.

TUTTLE, Circuit Judge: This is an appeal by five individual defendants from convictions for income tax law violations on all counts of seven different indictments. In one indictment the four defendants, Bernstein, Scherer, Hodesblatt (sometimes referred to as Hodes), and Hammerman, who were the sole officers, directors and equal stockholders of the Selray Corporation, were charged with

a conspiracy together and with defendant Gersch, an employee, to violate § 145(b) of the Internal Revenue Code of 1939,[1] by causing to be filed false and fraudulent returns for the Selray Corporation for the years ending October 31, 1947 and 1948. One indictment charged Gersch in two counts with aiding and abetting the other four in a willful and knowing attempt to defeat and evade a large part of the taxes of the Selray Corporation for 1947 and 1948. One count charged the four defendants, other than Gersch, in three counts with willfully and knowingly attempting to defeat and evade a large part of the taxes of the Selray Corporation for the years 1947, 1948 and 1949. One indictment charged defendant Bernstein in three counts with willfully and knowingly attempting to defeat and evade a large part of the income tax due and owing by him for the years 1947, 1948 and 1949. In three other indictments each of the other three individuals Scherer, Hodesblatt and Hammerman was charged in three counts each with similarly willfully and knowingly attempting to defeat and evade a large part of his personal income taxes for the same three tax years.

By the indictments and bills of particular filed in response to orders of the court, the government charged that the four officers of the Selray Corporation planned to and did cause the true income derived from the operation of the Selray Corporation's Surfside Hotel, in Miami Beach, to be understated by having the defendant Gersch rewrite the daily records of the hotel during certain seasons of the years 1946-47 and 1947-48, and by another employee

1 "Any person who wilfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony." 26 U.S.C. (1946 ed.) §145(b).

doing the same during the early part of 1949 by eliminating a substantial volume of room rentals from the records from which entries were made to the company's books, which were subsequently used as the basis for preparation of the company's income tax returns for the fiscal years in question. It was also charged that an amount of cash equalling the receipts thus omitted from the books of the company was accumulated by an employee of the hotel who delivered it to one of the defendants, and that substantially the same amount was paid over to the four stockholders as "dividends."

The government set out to prove its case by the aid of a Mrs. Jensen, formerly the "auditor" of the company who confessed to having played a part in the alleged fraudulent scheme although, according to her testimony, she refused for the first two years to do the job of "rewriting" the daily transcript.

The case was built up from certain books and records of the company which had been delivered by three of the defendants to the witness, Internal Revenue Special Agent Karo, when he commenced his investigation in 1951. He identified the journal, general ledger, duplicate guest bills and certain daily transcripts of room receipts.

The witness Jensen testified that in November, 1946, she was called into the office by defendant Hodesblat who told her he was interested in doing something to see "if they could hold out some income to keep the tax down"; that he told her: "Think about it, and we will discuss it later"; that he later told her: "They were going ahead with the plan. They were going to import a man to re-

write the transcript." She further testified that at about the same time she had a conversation with defendant Scherer, who said "that he had a very good friend that they were going to bring in to do this work who was fully qualified, and was a crackerjack at figures." She testified that later Scherer introduced her to Gersch and that Gersch had transcript sheets and arrival and departure records "and all the things that would be necessary for this particular work which is the same as is used at the front desk"; that "Mr. Gersch was the man to do the rewrite job, and that he would explain it to me and tell me how it was going to work." Finally Mrs. Jensen testified: "Mr. Gersch and I both spoke to Mr. Scherer and told him it was wrong to do this, and be sure he knew what he was doing, and Mr. Scherer this was [sic] what his partners wanted to do, and they would do it whether it was done here or whether they sent the records to New York to have the rewrite job done."

The witness then testified that beginning with December 9, 1946 and continuing until some time in April, the transcript sheets that were prepared by the room clerks were taken by Gersch and rewritten in a manner so as to drop off the receipts from a selected number of rooms, and that she then used the rewritten transcript sheets from which to make the postings to the journal and ledger, from which in turn the company's income tax was computed by outside accountants. Mrs. Jensen testified that the practice was again indulged in the winter season 1947-48 with Gersch as the active participant; further, that she herself, at the statement of Bernstein and Scherer in February, 1949, "that they would like to hold out ap-

proximately $25,000 of 1949 income," dropped out items of room income at the bottom of the transcript. She did this, she said, until she accumulated $24,683.78. It is not contended by the government that Gersch had anything to do with the 1949 records.

This witness said that she removed from the actual receipts each day cash equal to the items omitted and accumulated this in envelopes that she kept until they were asked for by one of the defendants. The government introduced in evidence receipts signed by three of the defendants, Hodesblatt, Bernstein and Scherer on different occasions, which Mrs. Jensen said she took from them when she surrendered envelopes filled with cash to them. On the occasion of the first delivery, she said she was called into a room in which all four stockholders were seated at a table and there was a pile of cash in front of each of them.[2]

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2 Since this testimony is critical as to the charges against the individuals, it is reported in some detail:
Q. Mrs. Jensen, what, if anything, happened after you received this receipt, Government's Exhibit 47, in evidence, and handed the money to Mr. Hodes in your office?
A. About ten minutes later Mr. Hodes called me and asked me if I would please come upstairs to his little office. I went upstairs and he said, "Mrs. Jensen, this cash isn't right."
Q. At that time who were present in that little office you are talking about?
A. Mr. Hodes,—all four of the gentlemen.
Q. Name the gentlemen.
A. Mr. Hodesblatt, Mr. Bernstein, Mr. Scherer, and Mr. Hammerman. Mr. Hodes was sitting at a little table on the side of the wall, and the three gentlemen were sitting in front of him.
Q. Where was the table?
A. The little table was opposite Mr. Hodes.
Q. Where was the table with regard to the other three?
A. In front of them; and Mr. Hodes had taken the money out and it was stacked up in piles around there, and he told me that the money was short what he had signed for.
Q. Before you go into that part, would you tell the gentlemen of the jury where that money was stacked?

The government's witness Karo then testified that from the documents turned over to him by some of the defendants in 1951 he had taken the duplicate guest bills covering the period during which Mrs. Jensen had testified the daily receipts had been tampered with, and compared these daily duplicate guest bills with the rewritten daily transcripts, as prepared by defendant Gersch, and, after allowing some credits that were properly applicable

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A. That money was stacked in front of each one of them.

. . . . . .

The Witness:

Mr. Hodes told me that the money he had there did not add up to what he had signed for. I said, "It has to be here." And I fumbled around on the desk, and there was another envelope that had some $500.00 in it that he had not picked up and opened up, and counted it; and he said, "Thank you." And I turned around and walked downstairs and that was the end of it.

Q. The little envelope that you found there, where did that come from?

A. That had come from expenses.

Q. Had you seen it before, that little envelope?

A. I had that envelope and gave it to him. I don't know whether there were three or four envelopes. The envelopes only held so much, and if it would need more, I would make more.

Q. Do you recall how much money was there at that time?

A. It is on the receipt.

Mr. Cunningham:

I object. There is no indication that this is the same money.

The Court:

If you know, was that the same money that was in the envelopes?

The Witness:

Yes, sir.

The Court:

And this receipt discloses the amounts?

The Witness:

Yes, sir.

(By Mr. Guilmartin):

Q. Referring to Government's Exhibit 47,—

The Court:

It speaks for itself.

Mr. Cunningham:

Could that be exhibited to the jury?

Mr. Guilmartin:

If you don't mind, I will read it.

in the case of some of the omitted receipts, he testified that during the months of December through April, 1946-47, $68,135.75 had been dropped out of guest receipts. In the same manner he testified that during the FY ended October 31, 1948, the sum of $35,542.56 had been dropped out, and during the following fiscal year $24,683.78 had been omitted.

Agent Karo testified to a computation in which, having figured the additional taxes that would be due from the corporation based on the inclusion of this omitted income, the corporation had available earnings for the respective years in question the following amounts: 1947—$60,346.70; 1948—$33,761.80; 1949—$17,384.83. He then testified to a computation showing the receipt by each of the four stockholder-defendants of one-fourth of each of these annual amounts. These computations showed additional unreported income of a total of $27,873.33 for each of the four defendants for the three years in question.

The defendants' attack on the judgment below is fourfold. These four grounds may be subdivided into two.

The first relates to sufficiency of the evidence and questions as to the correctness of the court's rulings on the admissibility of certain evidence. The second relates to charges by the court and counsel's opportunity to except thereto, and the court's general conduct of the trial.

Referring first to the sufficiency of the evidence, we think it quite clear from the foregoing statement of facts that there was ample evidence upon which the jury could find a willful intent on the part of the five defendants

to set up a system by which the corporation's income would be greatly distorted as it appeared on the books of account, and that this was done with the intent to defraud the government of a substantial part of the taxes owed by the Selray Corporation. We think it equally clear that the evidence warranted a finding by the jury that the amounts allegedly withheld from the corporation as a result of the rewriting of the transcripts and segregation of receipts was equally divided among the stockholder-defendants.

What has just been said assumes the competence of the evidence admitted by the court and the correctness of the trial court's decision to the effect that the actual receipt by each of the four stockholders of a proportionate amount of the withheld funds amounted to a receipt by them of "dividends." This ruling, which resulted from several different actions by the trial court as to the admission of testimony by Karo and the rejection of exhibits tendered by the defendants and restriction on the cross-examination of Karo, was vigorously attacked during the trial and is made one of the principal complaints here.

The sufficiency of Karo's evidence is attacked first on the ground that he reconstructed the actual room rent from duplicate bills without adequate evidence that the bills had in every instance actually been paid. The court correctly rejected this contention. First, because the duplicate bills were given to the special agents as records of the hotel company and may thus be considered as admissions against interest by it, and, since it was testified that the corporation was on an accrual basis, the creation of the account owing from the guests to hotel repre-

sented income on the day on which the charge was created, and any adjustment by reason of a failure to pay or any other ground would be taken on the books of the company as a deduction. There was no burden on the government to prove the correctness of such deductions by the corporation. Furthermore, it is clear that there was ample evidence that a very substantial part of these bills must have been paid in order to produce the amount of $117,000.00, which Mrs. Jensen testified had been held out of cash receipts. This was ample to satisfy the requirements as to prima facie proof.

The next contention by the defendants, to the effect that the government witness arbitrarily reconstructed receipts for certain months in the year without considering the duplicate bills for the rest of the year, cannot be seriously considered in the light of the testimony that the period selected for the reconstruction of the income by the special agent by reference to the duplicate bills coincides identically with the period during which Mrs. Jensen testified Gersch was employed for the first two years to falsify the records, and during which she herself, in the third year, did the same thing. In establishing its prima facie case against the individuals in the conspiracy indictment and in the charge of attempting to defeat and evade the corporation's tax, it was not necessary for the government to do more than offer proof that the defendants knowingly and intentionally conspired to and did exclude items of gross receipts from the books, since from the books themselves, which are in evidence, it appears that the other entries reflecting the corporation's operations were made the basis of the preparation of the income tax returns. It was not necessary to attempt to prove

whether additional amounts of room rentals were properly reflected in the other months of the year.

The defendants strongly challenge the evidence by which the government seeks to prove that the amounts distributed to the defendants constituted "dividends." They contend that under the bill of particulars the government is bound by its specification classifying these amounts as "dividends." The defendants, however, lay entirely too much stress upon the technical requirements as to the declaration of dividends by a corporation. In their brief, and before the trial court, they made an effort to establish the proposition of law that any payments received from a corporation by its stockholders in order to constitute dividends must be declared out of earned surplus. The statute defines dividends as "any distribution made by a corporation to its shareholders . . . (1) out of the earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year."[3]

The burden of the defendants' plea is that if the corporation had $117,000.00 more earnings than it showed on its books, there would arise, as a liability, an additional tax on such amount, and, as we understand it, there would also arise liability in the way of a negligence penalty of 25%, together with interest at 6% on the principal amount of the tax, plus a fraud penalty of 50%, all of which liabilities should be deducted from the corporation's earned surplus in the respective fiscal years before any dividends could be declared or paid. Defendants complain of the court's refusal to let them attempt to show

[3] 26 U.S.C.A. (1945 ed.) §115(a).

the amount of such penalties by additional cross-examination of the witness Karo, or by affirmative testimony and the introduction of a memorandum presented their counsel at a hearing in the office of the Regional Counsel of the Penal Division, who discussed amounts of alleged deficiencies and penalties in a conference with such counsel. No assessment of any additional taxes or negligence or fraud penalties or interest was ever made.

The special agent testified that in computing the availability of earned income for distribution as dividends, he considered the earned surplus of the corporation. We think it quite clear that he did not consider any fraud penalty or negligence penalty or interest resulting from the failure of the corporation correctly to pay and report its taxes. Obviously such computation had no part in ascertaining the financial position of the Selray Corporation as of the dates on which the jury found its officers received the unreported income. It would indeed be a strange rule that would require the accrual of fraud and delinquency penalties in determining the amount of earned surplus, for, of course, if the corporation carried out its legal responsibilities, no liability for such penalties would ever arise. As already stated, no such penalties have ever been assessed against the corporation, and in view of the results of the criminal proceedings, they may never be. It lies within the discretion of the Secretary of the Treasury to compromise the civil liabilities and, in the light of the result of the criminal proceedings, it is not at all certain what disposition would ultimately be made of any penalties that may be ascertained against the corporation. Moreover, it is not consistent with our ideas of proper accounting practice for officers and directors of a

corporation to be permitted to conduct the affairs of their corporation in such a way as to defraud the government and then assert the existence of a fraud penalty as a corporate liability, and thus translate what would otherwise be a dividend distribution to themselves into a distribution of capital. If the Tax Court case of *Esther M. Stein v. Commissioner*, 25 T.C. . . . , No. 109, holds to the contrary we are not disposed to follow it.

The government cites the case of *Poncet Davis v. U. S.* (6 Cir.), 226 F. 2d 338, as supporting its contention that the legal ability of the corporation to declare dividends is immaterial in a case where corporate stockholders withdraw funds from a corporation and fail to report them. The appellants counter by showing that in the Poncet Davis case the government was not bound, as it was here, by a bill of particulars alleging that the payments made to the appellants were "dividends." We do not place our decision on this phase of the case on the authority of the Poncet Davis case. We put it on the ground that the corporation's earned surplus account was and should have been considered without reference to any future determination by the Commissioner of Internal Revenue that the corporation was subject to the delinquency or fraud penalties or the fact that it would owe interest on deficiencies in its normal tax.

Substantially all of the criticism leveled by appellants at the failure of proof of the payment of dividends is answered by this determination; so also is the criticism of the trial court's refusal to permit further cross-examination of the witness Karo, and examination in chief

of defendants' witness Kantzler, and the court's rejecting defendants' proffered exhibits, which undertook to reconstruct the corporation's balance sheet by adding these items of fraud and delinquency penalties and interest. The court is not required to permit cross-examination of a witness in an effort to prove he did not include in his calculations an element which it would have been improper for him to include. Counsel was permitted to cross-examine Karo amply to prove that he did consider the company's earned surplus but that he did not include the liabilities just discussed in his computations. Likewise, the court correctly rejected defendants' proffer of an exhibit that was comprised of calculations not based on any of the evidence before the court.

The third general ground of complaint by appellants is their contention that the trial court erred in three particulars in charging the jury and in "denying" appellants' counsel opportunity to except to charges as given out of hearing of the jury.

Touching on the last criticism first, we find no justification for the position taken by counsel. The court, in his charge, showed a lively sense of appreciation of its relation to the parties and their counsel, commenting specifically on its manner of conducting the trial and cautioning the jury not to be influenced by any apparent severity or agreeableness toward counsel.[4] We have

[4] The court included in its charge the following:
"A further instruction of the defendants. Gentlemen, we have elsewhere told you that you are the exclusive judges of the facts, and the Court is the exclusive judge of the law. In passing upon the facts, if you should have any idea or conception of what the Court believes about them, do not be influenced thereby. Moreover, do not try the lawyers in the case. The Court has at times

carefully read the entire record, of course, including the charge, and we find no indication that the court would in any way have embarrassed counsel or their clients before the jury if counsel had made the simple request of an opportunity to make objections to the charge out of the presence of the jury. Counsel did not make such request. The Court's failure to excuse the jury *sua sponte* to invite objections from counsel was not error. This was not a case in which the court declined to hear the exceptions out of the jury's presence. Thus, we do not think the case of *Lovely v. U. S.* (4 Cir.), 169 F. 2d 386, applies. For all that appears, counsel had ample opportunity to make a request for his right to discuss the charges in a way that would not put him in a bad light with the jury. Moreover, it appears that the jury was twice instructed after first retiring and counsel had ample opportunity to make his objections while these matters were being discussed with the court. Cf. *Schaffer v. United States* (5 Cir.), 221 F. 2d 17.

The most serious challenge to the judgment of conviction arises from the inclusion in the court's charge on intent of the following language:

> "The law presumes that every man intends the legitimate consequences of his own acts,"

during the trial endeavored to prod counsel and get them to go forward. They may not have been successful in doing so. Do not charge the defendants or the Government with their conduct in this respect. And if the Court has seemed to be severe in any instance, do not let that influence you as against or in favor of the parties. If the Court has seemingly been polite or agreeable to any witness or any person in the trial, these matters will not be noticed by you. Try the defendants upon the evidence submitted, and the evidence from the witness stand only."

and

> "A man is charged with knowledge of that which naturally and normally from all the evidence flows or results from his acts normally done or performed."

It is doubtless true, as we said in *Dupree v. United States* (5 Cir.), 218 F. 2d 781, that, in the absence of a presumption created by statute, it is much the better practice for the trial court to charge a jury in a criminal case on permissable inferences that may be drawn from the evidence rather than charging in terms of presumptions. Nevertheless, we do not conceive it to be the law that every charge of a presumption other than that of innocence is reversible error in a criminal trial.[5]

Inasmuch as we have concluded that this language in the charge of the trial court here was not reversible error, we reproduce the unusually full and complete charge of the court on intent in the footnote.[6]

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5 In this connection see Pollock v. United States (5 Cir.), 202 F. 2d 281, where this court, in a footnote, seems to have approved a charge that stated, in a net worth prosecution, "The increase, if any, in net worth is presumed to be net income if certain conditions obtain."

6 "The question of intent is a matter for you, as jurors, to determine, and, as intent is a state of mind, and it is not possible to look into a man's mind to see what went on, the only way you have of arriving at the intent of the defendants or defendant in this case, and you must consider each defendant separately as respects to each charge made, and each count in each indictment, is for you to take into consideration all of the facts and circumstances shown by the evidence, including the Exhibits, and determine from all such facts and circumstances what the intent of the defendant was at the time in question.
"The Government contends that there was 'an attempt to evade' by the defendants, and that such attempt was wilful on their part.
"The defendants contend that they never 'attempted to evade' any of their taxes, and that there was no wilfulness on their part.

It would, of course, be reversible error for a trial court to charge that if the jury found that the accused caused the daily transcript to be rewritten, there was a presumption that they intended to defeat and evade the corporation's income tax. This is substantially what the

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"The requirement that an 'attempt to evade', the 'wilful', means that you must pass to some extent upon the mental state of the defendants at the time the 'attempts' to evade occurred. 'Wilfulness' is largely a matter of 'intention.' There must be a wrongful intent in the defendants' minds before they can be found guilty of wilfully attempting to evade their taxes.

"Before any attempt to evade taxes can be wilful, it is, of course, necessary that the person or persons making the attempt have some actual knowledge of his tax obligation, and that such obligation exceeded the amount reported by him. Otherwise there could be nothing which he could 'intend' to evade. Having such knowledge, he can then wrongfully intend to evade his tax obligation or part of it.

"Wilfully, as used in connection with this offense, means knowingly and with bad heart and with a bad intent. It means having the purpose to cheat or defraud or to do a wrong in connection with a tax matter. It is not enough if all that is shown is that the defendant was stubborn or stupid, careless, negligent, or grossly negligent. A defendant is not wilfully evading a tax if all that is shown is that he is careless about keeping his books. He is not wilfully evading a tax if all that is shown is that he made errors of law. He is not wilfully evading the tax if all that is shown is that he in good faith acted contrary to the regulations laid down by the Bureau of Internal Revenue of the United States Deparment of the Treasury. He is not wilfully evading a tax if all that is shown is that he failed to hire competent bookkeepers or accountants.

"The wilfulness necessary may best be described as the state of mind of the taxpayer wherein he is fully aware of the existence of a Tax obligation to the Government which he seeks to conceal. The wilful evasion of a Tax requires an intentional act or omission as compared to an accidental or inadvertent one. It also requires a specific wrongful intent to conceal an obligation known to exist as compared to a genuine misunderstanding of what the law required, or a bona-fide belief that all receipts had been reported by one's employees. Therefore, if you have a reasonable doubt after a consideration of all the evidence, that the defendants and each of them believed that all of his receipts had been reported in the books of the Selray Corporation by his bookkeeper or accountant, then you should return a verdict of not guilty.

trial court did in *Morissette v. United States*, 342 U.S. 246. There the trial court charged:

> "And I instruct you to this effect: That if this young man took this property (and he says he did), without any permission (he says he did), that was on the property of the United States Government (he says it was), that it was of the value of one cent or more (and evidently it was), that he is guilty of the offense charged here. If you believe the government, he is guilty . . . . The question of intent is whether or not he intended to take the property. He says he did. Therefore, if you believe either side, he is guilty. Petitioner's counsel contended, 'But the taking must have been with a felonious intent.' The

"Now the mere fact that a taxpayer knew he had income which he did not report and did not pay tax on, even though he knew a tax was due, is not itself alone sufficient to constitute a violation of the law here involved. There must be a wilful and positive commission of an act or acts in the attempt to evade taxes.

"In explanation of that last charge, if somebody had something in mind, that wouldn't be enough. You would have to go forward and do something about it.

"The defendants in this case cannot be found guilty simply because they may have failed to include in their Income Tax Returns items of income or sources of income that should have been included. They can only be found guilty in the event that they wilfully and knowingly undertook to evade the Tax as charged in the indictment.

"Now intent may be ascertained from all the facts in evidence and the inferences that reasonable men might naturally draw from the evidence. The law presumes that every man intends the legitimate consequences of his own acts, and a man is charged with knowledge of that which naturally and normally from all the evidence flows or results from his acts normally done or performed. There must be a union or joint operation of act and intent. It is not possible to look into the mind of man and see what its workings are, or to bring a photograph of the mind of a man and exhibit it to the jury, so as to determine clearly and absolutely what the workings of a human being's mind are, and from necessity, intent with which an act is done is to be drawn or determined from all the surrounding circumstances."

court rules, however: 'That is presumed by his own act.' " 342 U.S. 246 at 249.

Here the government undertook to show that the accused caused transcripts of daily receipts to be rewritten; thereafter that the written transcripts were used as the basis of the entries in the books of account. There was no proof that instructions were given that the omissions from daily receipts were to be translated into the income tax returns. It seems clear that the language here complained of was directed to connecting the alleged instructions to the employees to drop out the receipts to the natural result of this step, i.e., that the same omission would show up in the books of account and the income tax returns. We think this is apparent from the inclusion of the word "legitimate" in the challenged charge. This is not the same as saying that the law presumes that every man intends the consequences of his own acts, even though an illegal consequence occurs. As we have indicated, it would have been more in accord with recognized principles for the court to have said in effect "If you believe that the defendants instructed Gersch or Mrs. Jensen to omit room rentals from the daily transcripts, you may infer from that that they knew and intended that the figures, thus rewritten, would be reflected in the books of account and in the income tax returns of the corporation." Since however, the court had already charged the jury that even a knowing omission of taxes they knew to be due was not sufficient to supply the ingredient of wilful intent, this keeps the challenged charge from having any-

thing like the vice of the charge struck down in the Morissette case. In view of the lengthy explanation of the elements of wilfulness and intent, it is clear that the defendants could not have been prejudiced by the language complained of. Nothing in *Wardlaw v. United States* (5 Cir.), 203 F. 2d 384, is in conflict with what we decide here, because there the court did not use the word "legitimately," and further added the specific statement "the natural presumption would be if a person consciously, knowingly or intentionally did not set up his income and thereby the government was cheated or defrauded of taxes, that he intended to defeat the tax." Thus, the only inquiry left for the jury in the Wardlaw case was whether the taxpayer knowingly failed to report the correct tax. He admitted that he had done so, but sought to explain his failure on an honest misconception of law. The charge deprived him of this defense.

Nor do we find any conflict with the decision of this court in *Hargrove v. United States* (5 Cir.), 67 F. 2d 829. There the trial court specifically charged that if the accused intended to do the act (failing to file a return where one was due) then this intent supplied the element of wilfulness under the statute. Such a charge was clearly erroneous because it failed to take into account the distinction between offenses which are *mala prohibita* and those in which a specific wilful intent must be shown. Here the charge that the jury must find a specific wilful intent in order to convict was full and complete.

So, too, does the instruction here differ from that in *Barfield v. United States* (5 Cir.), 229 F. 2d 936. There, in a prosecution for transportation of a stolen automobile

interstate, knowing it to have been stolen, the court charged:

> "Proof that a defendant was in possession of property (the accused admitted he was driving the automobile) recently stolen raises a presumption of guilty knowledge."

This court coupled this charge with a failure to define possession as constituting prejudicial error, because a type of possession (driving the car) was admitted, and the fact that the vehicle had been recently stolen was undisputed. The charge thus practically amounted to an instruction that on the facts the accused was presumed to be guilty, because the element of knowledge was the only unproved element of the offense.

We conclude that the proper rule is stated in *Imholte v. United States* (8 Cir.), 226 F. 2d 585; *Banks v. United States* (8 Cir.), 223 F. 2d 884; and *Bateman v. United States* (9 Cir), 212 F. 2d 61. Where, as here, the entire charge on intent clearly gives the jury the correct legal standard to apply, the use of the challenged phrase on presumption does not constitute reversible error.

The second challenge to the court's charge which appellants press here is its definition of reasonable doubt. The court gave a charge on reasonable doubt as requested by the appellants.[7] This was given as a part of what the

7 "Further on the defendants' instructions. From the beginning of the trial until the end, the Government has the burden of establishing beyond a reasonable doubt, every fact essential to the conviction of the defendants. The defendants have no burden to sustain. It is enough that their evidence taken with the Government's, raises a reasonable doubt as to their guilt, and if it does so raise a reasonable doubt, in that case they must be

court denominated "the defendants' instructions," a description of dubious value when all of the charge is supposed to represent what the court considers as the law applicable to the case. The court later gave a further charge "of my own choosing" on reasonable doubt.[8] This charge included the challenged statement "It simply means what the impression implies, and that is a doubt for which a reasonable man can give a reason."

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acquitted of whatever particular Indictment or count you are considering in respect to any of the Defendants. The Defendants, as the Court has charged you, are presumed to be innocent, and this presumption continues throughout the trial and during the deliberations of the jury, and is overcome when and only when their guilt is established beyond a reasonable doubt.

"The term 'reasonable doubt' means just what the term implies. By 'reasonable doubt' I do not mean to be understood as stating that the defendants must be found guilty beyond all doubt whatsoever, but beyond a doubt founded in reason and arising from the evidence. 'Reasonable doubt' means such a doubt as will leave in the jurors' mind, after a candid and impartial consideration of all the evidence, so undecided that he is unable to say that he has an abiding conviction or assurance of the defendants' guilt. It is not a vague, possible or speculative doubt, but such a reasonable doubt as remains in the minds of reasonable jurors after a careful consideration of all the testimony.

"I will give you further instructions on reasonable doubt of my own choosing later on."

[8] "Now as to reasonable doubt. By reasonable doubt is not meant a speculative or suppositious doubt. It simply means what the expression implies, and that is a doubt for which a reasonable man can give a reason. If after you have carefully considered and weighed all of the evidence in the light of the law which the Court now gives you, you have a full, firm and abiding conviction to a moral certainty that the defendant is guilty as charged in the Indictment or any count thereof, then his guilt has been established beyond a reasonable doubt. If you do not have such a full, firm and abiding conviction, then his guilt has not been established beyond a reasonable doubt. The law does not require a person to be proven guilty beyond a mathematical certainty, but only to a moral certainty."

It is very difficult to see how, in the light of the entire charge of the court, this attempt to define reasonable doubt could really be harmful to appellants. The use of this language was discussed in *Schaffer v. United States* (5 Cir.), 221 F. 2d 17, when a similar challenge was made to the use of this definition. We will adhere, however, to the course of action taken by the Supreme Court in *Holland v. United States*, 348 U.S. 121, where the trial court had charged that reasonable doubt was "the kind of doubt . . . which you folks in the more serious and important affairs of your own lives might be willing to act upon." The court criticized this definition as tending to create confusion rather than misapprehension and quoted a statement from *Miles v. United States*, 103 U.S. 304, 312: "Attempts to explain the term 'reasonable doubt' do not usually result in making it any clearer to the minds of the jury." The court then said that in spite of this "confusing" charge, which seems to us to be at least as inappropriate as the one here complained of, "we feel that, taken as a whole, the instructions correctly conveyed the concept of reasonable doubt to the jury." So, here we do not feel that this charge, if error, was prejudicial.

The third complaint as to the court's charge arises from the manner in which the court outlined the prosecution's contentions. In several places, where the court referred to withholding of money, receiving of dividends, or misdeeds taking place, it did not immediately qualify such statements by saying that these things were charged by the government. We have carefully considered each of these challenged references and are satisfied that it was

abundantly clear that the jury was fully apprised that these were merely matters alleged by the government and were not matters stated by the court to be true. There was no error here.

We turn finally to the contention that the trial court unduly restricted appellants' counsel in his cross-examination and that he commented on the evidence and questioned the witnesses in a prejudicial manner. It appears that the trial judge kept a strict reign on counsel; it is also apparent that the court frequently caught the significance of the testimony of witnesses before counsel thought they had fully developed the matter for the benefit of the jury. On some of such occasions the court paraphrased or reworded the testimony and then asked the witness as to the correctness of his understanding. At times also the court sought to make clear to the jury the theory of the prosecution's case. Upon a careful reading of the record it is apparent that counsel for both government and appellants received abrupt though not severe treatment at the hands of the court. However, it is amply clear that the court sought at all times to provide the accused the opportunity to develop the full case which the court felt was legally available to them. It was principally his strict adherence to the applicable theory of prosecution and defense that seems to have caused counsel's feeling of frustration and severity of treatment. The court was at no time discourteous or thoughtless in his rulings. Nothing appears in the record to indicate that the judge did or said anything that prejudiced appellants or their counsel with the jury. As to his attitude towards counsel and as to his desire to protect against any possible adverse

impressions resulting therefrom the trial court gave a specific charge, *supra*, footnote 6, which would certainly be calculated to leave all parties and the jury with a feeling that the case was to be decided strictly on the sworn testimony, and that all else, other than the judge's charge, was unimportant in their deliberations. As to the court's efforts to keep the precise issues before the jury, we think the language of the Supreme Court in *Holland v. United States*, 348 U.S. 121, is reasonably applicable to any income tax prosecution to the effect that in cases of this complexity, the court must at all times make the issues clear to the jury and explain inferences that can be drawn both for and against the accused.

There being no reversible error, the judgment is AFFIRMED.

(APPENDIX "B")

DEFENDANTS' EXHIBIT 1 FOR IDENTIFICATION
ATL-530019

SELRAY CORPORATION

Net Income

Fiscal Year	Per Return	Corrected	Additional
10-31-47	$18,010.96	$118,291.31	$100,280.35
10-31-48	15,177.04	65,234.82	50,057.78
10-31-49	(2,140.71)	34,733.90	36,874.61
Total	$31,047.29	$218,260.03	$187,212.74

Tax

Fiscal Year	Per Return	Corrected	Additional
10-31-47	$ 4,042.52	$ 44,950.69	$ 40,908.17
10-31-48	3,390.72	24,789.23	21,398.51
10-31-49	—0—	10,908.97	10,908.97
Total	$ 7,433.24	$ 80,648.89	$ 73,215.65

Penalties

Fiscal Year	Delinquent Penalty	Fraud Penalty	Total Tax and Penalties
10-31-47	$11,237.67	$ 20,454.09	$ 72,599.93
10-31-48	6,197.31	10,699.26	38,295.08
10-31-49	2,727.24	5,454.49	19,090.70
Total	$20,162.22	$ 36,607.84	$129,985.71

DEFENDANTS' EXHIBIT 17
FOR IDENTIFICATION

ANALYSIS OF TAXABLE DIVIDENDS AVAILABLE FOR YEARS 1947, 1948, 1949 TO STOCKHOLDERS OF SELRAY CORP.

* * * * * * * *

	1947	1948	1949
Hammerman*	None	None	None
Hodes*	None	None	None
Bernstein*	None	None	None
Scherer*	None	None	None

NOTE*—There would be no change in income for the tax returns and no additional tax due for any of the stockholders for any of the above years.

SELRAY CORP.

ADJUSTMENT OF EARNED SURPLUS

OCTOBER 31, 1946

* * * * * * * *

SURPLUS PER TAX RETURN—OCTOBER 31, 1946	$ 16,153.61
Less: Adjustments	
Rental 2/8/46-8/31/56, $1,505,000.00 Equivalent To $8,349.90 Per Month Proper Charge 2/8/46 - 10/31/46	$73,061.62

Amount Deducted Fiscal Year 10/31/46	66,666.67	$6,394.95	
Reserve For Inventory Losses		3,000.00(1)	
Replacements Charged To Capital			
Rugs Replaced October 1946	2,750.00		
Reserve For Legal Costs and Possible Liquidated Damages On Lease Because of Gambling Activities at Hotel and Bad Relations with Lessor	5,000.00(2)		17,144.95
ADJUSTED EARNED SURPLUS DEFICIENCY OCTOBER 31, 1946			$ 991.34

(1) Desire to build up a reserve for losses on inventory shortages in the amount of $10,000.00 at the rate of $3,000.00 per annum for three years and $1,000.00 for the 4th year.

(2) Legal fees of $5,000.00 alone were paid in fiscal year 10/31/51 as a direct corrollary to elisor raid of April 1949 at behest of lessor.

1.) **SELRAY CORP. NET LOSS FISCAL YEAR ENDING OCTOBER 31, 1947**

ADJUSTED NET INCOME			$118,291.31
DEDUCTIONS NOT ALLOWED			
Amount of Additional Income Added	$100,280.35		
Less: Amount of Difference Added	57,880.70	$ 42,399.65	
Other Adjustments			
Addition To Reserve For Inventory Losses		3,000.00	
Federal Taxes:			
Tax	$ 44,950.69		
Penalty—Delinquency	11,237.67		
Penalty Fraud	20,454.09		
Interest On Added Tax To 11/15/54	16,772.35	93,414.80	
TOTAL DEDUCTION FROM ADJUSTED NET INCOME			138,814.45
NET LOSS FOR FISCAL YEAR ENDING OCTOBER 31, 1947			$ 20,523.14

2.) SELRAY CORP. NET LOSS FISCAL YEAR ENDING OCTOBER 31, 1948

ADJUSTED NET INCOME			$65,234.82
Deductions Not Allowed			
Amount of Additional Income Added	$ 50,057.78		
Less: Amount of Difference Added	36,227.80	$ 13,829.98	
Federal Taxes:			
Tax	$ 24,789.23		
Delinquency Penalty	6,197.31		
Fraud Penalty	10,699.26		
Interest On Added Tax To 11/15/54	7,489.48	49,175.28	
Addition To Reserve For Inventory Losses		3,000.00	66,005.26
NET LOSS FOR FISCAL YEAR ENDING OCTOBER 31, 1948			$ 770.44

3.) **SELRAY CORP. NET LOSS FISCAL YEAR ENDING OCTOBER 31, 1949**

ADJUSTED NET INCOME			$ 34,733.90
Deductions Not Allowed			
Amount of Additional Income Added	$ 36,874.61		
Less: Amount of Difference Added	24,078.10	$ 12,796.51	
Federal Taxes:			
Income Tax	$ 10,908.97		
Delinquency Penalty	2,727.24		
Fraud Penalty	5,454.49		
Interest On Added Tax To 11/15/54	3,163.60	22,254.30	

Addition To Reserve For Inventory Losses	1,000.00	
Reserve For Repairs (Repairs For Prior Two Years Were In The Approximate Amount of $11,000.00; Repairs For This Year Were Less Than $2,000.00)	3,000.00	39,050.81
NET LOSS FOR FISCAL YEAR ENDING OCTOBER 31, 1949		$ 4,316.91

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In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 393

GEORGE BERNSTEIN, et al., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Court of Appeals (Pet. App. 1a-24a) is reported at 234 F. 2d 475.

JURISDICTION

The judgment of the Court of Appeals was entered on May 31, 1956. (Pet. App. 1a) A petition for rehearing was denied on August 7, 1956. The petition for certiorari was filed on September 6, 1956. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTIONS PRESENTED

1. Whether funds, representing unrecorded and unreported receipts, diverted by petitioners from a corporation of which they were the sole stockholders are taxable to them as dividend income.

2. Whether, in the light of the charge as a whole, it was prejudicial error for the court to include in the instructions on intent the language that "the law presumes that every man intends the legitimate consequences of his own acts."

3. Whether, in the absence of a request to do so, the court's failure to excuse the jury while petitioners' counsel stated his objections to the charge, was prejudicial error.

STATUTE AND RULE INVOLVED

Internal Revenue Code of 1939:

SEC. 145. PENALTIES.

* * * * *

(b) *Failure to Collect and Pay Over Tax, or Attempt to Defeat or Evade Tax.*—Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000, or imprisoned for

not more than five years, or both, together with the costs of prosecution.

* * * * *

(26 U.S.C. 1952 ed., Sec. 145(b).)

Federal Rules of Criminal Procedure:

Rule 30. INSTRUCTIONS.

At the close of the evidence or at such earlier time during the trial as the court reasonably directs, any party may file written requests that the court instruct the jury on the law as set forth in the requests. At the same time copies of such requests shall be furnished to adverse parties. The court shall inform counsel of its proposed action upon the requests prior to their arguments to the jury, but the court shall instruct the jury after the arguments are completed. No party may assign as error any portion of the charge or omission therefrom unless he objects thereto before the jury retires to consider its verdict, stating distinctly the matter to which he objects and the grounds of his objection. Opportunity shall be given to make the objection out of the hearing of the jury.

STATEMENT

On January 27, 1954, seven indictments were returned in the United States District Court for the Southern District of Florida charging petitioners with attempted evasion of their individual income taxes, and of the income taxes of a corporation of which they were the sole stockholders, for the years 1947, 1948 and 1949, and with a conspiracy to evade the corporate taxes. The

reported and the corrected net income and tax liability as alleged in the several indictments were as follows (R. 1-3, 40-42, 56-58, 73-76, 92-95, 117-119, 130-132):

		Reported		Corrected	
Year	Taxpayer	Income	Tax	Income	Tax
1947	Bernstein	$17,783	$ 4,619	$32,869	$12,776
1948	Bernstein	4,989	230	13,430	1,857
1949	Bernstein	932	-00-	4,751	191
1947	Scherer	14,371	3,790	29,290	11,551
1948	Scherer	9,351	1,473	17,744	3,572
1949	Scherer	4,742	588	9,089	1,416
1947	Hammerman	11,865	3,000	26,951	10,469
1948	Hammerman	4,256	507	12,696	2,238
1949	Hammerman	1,863	110	6,210	859
1947	Hodesblatt	16,400	4,448	31,486	12,551
1948	Hodesblatt	12,876	2,142	21,317	4,461
1949	Hodesblatt	5,207	565	9,132	1,309
Oct. 31					
1947	Selray Corp.	18,010	4,042	75,424	28,661
1948	Selray Corp.	15,177	3,390	51,404	19,533
1949	Selray Corp.	(2,140)	-00-	21,607	4,901

After a jury trial, petitioners were found guilty as charged. (R. 22, 54, 70, 80-83, 107-110, 127, 145.) On December 10, 1954 each of the petitioners was sentenced to imprisonment for one year on each count on which he was convicted the sentences to run concurrently, and, with the exception of Gersch, each was fined varying amounts. (R. 30-32, 55-56, 71-72, 83-91, 110-117, 128-129, 145-147.) The Court of Appeals unanimously affirmed (Pet. App. 1a-24a.)

The evidence to support the verdict may be summarized as follows.

Petitioners Bernstein, Hammerman, Scherer and Hodesblatt, also known as Hodes, were the officers, directors and sole and equal stockholders of the Selray Corporation which leased and operated a beachfront hotel, known as the Surfside, in Miami Beach, Florida. (R. 222-225.) Petitioner Gersch, an accountant, was

employed by the officer-stockholders to prepare false records in furtherance of a plan to defeat and evade the income tax of the Selray Corporation. (R. 542, 549-550.)

The corporation's books were kept and its tax returns were filed on an accrual basis and for fiscal years ending October 31. (R. 160-161.) Eileen Jensen was employed as bookkeeper and office manager. Insofar as pertinent, the underlying records of income from the operation of the hotel consisted of "daily transcripts" which reflected all charges to guests; "front office" cash sheets on which were entered receipts from and expenditures for guests; and the duplicate copies of guest bills which the hotel retained and which also reflected all charges to guests. The daily transcript and cash sheets were prepared by the desk clerks and were audited daily by Jensen who made the postings to the general ledger from which the tax returns were prepared. (R. 521-541.)

In the early part of November 1946 (R. 544-545), Hodesblatt, who was president of the corporation, told Jensen that "he was interested in doing something to see if they could hold out some income to keep the tax down" and that she should "think about it, and we will discuss this later" (R. 546). Shortly thereafter (R. 547), Hodesblatt informed her that "they were going ahead with the plan" and that "they were going to import a man to re-write the transcript" (R. 548). About the same time, Scherer told her that "he had a very good friend that they were going to bring in to do this work who was fully qualified, and was a crackerjack at figures". (R. 549.) Later the same month, Scherer introduced Jensen to the petitioner Gersch and in-

formed her that "Mr. Gersch was the man who was going to do the re-write job" and that Gersch would explain to her the details of the plan to omit income from the corporate books and tax returns. (R. 550, 553, 554.) Jensen testified that she and Gersch told Scherer at the time that "it was wrong to do this, and be sure he knew what he was doing" to which Scherer replied that "this was what his partners wanted to do, and they would do it whether it was done here or whether they sent the records to New York to have the re-write job done". (R. 551.)

About December 9, 1946, Gersch came to Jensen's office in the hotel, showed her the first daily transcript sheets which he had "re-written", and explained the details of the scheme designed to evade the corporation's taxes. The plan was as follows: The original daily transcript prepared by the night clerk was to be used by Gersch in preparing a second transcript in which he would omit the income attributable to a selected number of rooms. The front office cash sheet was to be re-written or altered in order to erase any record of the receipt of the omitted income. Jensen was to audit daily the original transcript and cash sheet as had been her practice. However, she was to post to the general ledger the amounts of room revenue and cash receipts as reflected in the false transcripts and altered cash sheets. She was to deposit only the amount of cash receipts as shown by the altered records. The difference, corresponding in amount to the omitted income, was to be segregated by her in an envelope and placed in a hotel lock box until such time as the officers called for it. (R. 553-566.)

The scheme to evade taxes was carried out during a part of each of the corporation's fiscal years ended in

1947, 1948 and 1949. The periods involved were from December 1946, through April 1947; from November 1947, through April 1948; and from February through April 1949. (R. 558-560, 599-600, 618, 637.) Gersch participated in the scheme as planned during the periods in 1946, 1947, and 1948; he did not participate in 1949. (R. 600, 618-619.) In February 1949, Bernstein and Scherer requested Jensen "to hold out approximately twenty-five thousand dollars of 1949's income." (R. 618.) She did so by falsifying footings on the daily transcripts and cash sheets and posting the false figures to the general ledger. A set of false records was not prepared for the three month period in 1949. (R. 618-620.)

The unrecorded and unreported receipts thus diverted from the corporation were turned over by Jensen to the officer-stockholders, periodically, at their request, at which times Jensen obtained from them receipts for the money. The Government introduced in evidence receipts for these funds signed by three of the petitioners, Bernstein, Scherer and Hodesblatt. (R. 563-631, Ex. 47-51.) Jensen delivered the first envelopes containing the withheld receipts to Hodesblatt in February 1947. (R. 566.) About ten minutes after delivering the envelopes, she was called by Hodesblatt to a small room in the hotel which was used by the officers. There she found the four officers seated around a table with a pile of cash in front of each. Upon entering Hodesblatt told her that "the money he had there did not add up to what he had signed for." She then looked around the table and found an unopened envelope which contained the difference. (R. 582-584.) On another occasion when she was asked by Scherer for $12,000 of

the withheld funds, she prepared four envelopes with $3,000 in each. (R. 623-631.)

At the direction of Bernstein, Hodesblatt and Scherer, Jensen destroyed substantially all of the true daily transcripts and cash sheets for the periods involved together with certain other hotel records before she terminated her employment with the corporation. (R. 637, 642-646, 736.) The duplicate copies of the guest bills which reflected all charges to guests were not destroyed. These together with other books and records of the corporation were turned over to the agents by the officers in the course of the investigation. (R. 735-736.)

The agents determined the correct amounts of revenue received by the corporation during the months in which the scheme to evade taxes was in operation by auditing the duplicate copies of the guest bills and comparing the resultant figures with the amounts entered in the appropriate revenue account in the general ledger. The amounts of revenue omitted from the books and tax returns for the fiscal years ended in 1947, 1948 and 1949 were $57,880, $36,227, and $24,078, respectively, or a total of more than $118,000. After taking into account the correct tax liability of the corporation, computed after adding the omitted income to gross receipts as reported, the agents made a computation which showed earnings or profits available for distribution as dividends in each of the fiscal years in the following amounts which total in excess of $111,000: 1947, $57,880; 1948, $36,227; 1949, $17,384. The amounts diverted from the corporation by the officer-stockholders in the calendar years 1947, 1948 and 1949, no part of which was reported by them in their individual returns, were as follows: 1947, $68,135; 1948, $35,542;

1949, $24,683. The available earnings or profits of the corporation during the calendar years 1947, 1948 and 1949 were sufficient to cover dividend distributions in the amounts of $60,347, $33,761, and $17,384, respectively. One fourth of the latter amounts was included in the unreported income alleged in the indictments charging each of the four officer-stockholders with attempted evasion of individual income tax, and these sums were identified by the Government in its bills of particulars as dividend income from the Selray corporation. (R. 12, 67, 124, 141, 735-905; Ex. 1, 25, 47-51, 64-70.)

At the trial, petitioners made a proffer of evidence to show that during the fiscal years involved the corporation had no earnings or profits available for distribution as dividends, and that, consequently, the diverted funds could not constitute dividend income to the officer-stockholders as alleged in the bills of particulars. Through the testimony of an attorney who had represented petitioners at a conference with representatives of the Internal Revenue Service, an exhibit (Pet. App. 1b) was offered which purported to show a calculation by the Service of proposed deficiencies and civil penalties against the corporation for the years involved herein. (R. 1056-1078.) A second exhibit was offered (Pet. App. 2b-5b) through the testimony of an accountant which purported to show that after accruing the proposed deficiencies and civil penalties, with interest thereon to the date of trial, the corporation had no earnings or profits available for distribution as dividends in any of the years in question. (R. 1194-1209.) The proffered evidence was excluded by the court as immaterial and irrelevant. (R. 1070, 1078, 1205-1206, 1209-1210.)

The court instructed the jury on the element of wilfulness, in part, as follows (R. 1244-1245):

> Now intent may be ascertained from all the facts in evidence and the inferences that reasonable men might naturally draw from the evidence. The law presumes that every man intends the legitimate consequences of his own acts, and a man is charged with knowledge of that which naturally and normally from all the evidence flows or results from his acts normally done or performed. There must be a union or joint operation of act and intent. It is not possible to look into the mind of a man and see what its workings are, or to bring a photograph of the mind of a man and exhibit it to the jury, so as to determine clearly and absolutely what the workings of a human being's mind are, and from necessity, intent with which an act is done is to be drawn or determined from all the surrounding circumstances.

After completing the principal portions of the charge to the jury, the court stated to counsel (R. 1247): "I think I have covered each of the instructions you gentlemen have submitted and we agreed on." Petitioners' counsel then stated: "If the Court please, I'd like to be heard on certain matters." The court asked if there were any more instructions and a defense request to give "Instruction No. 8" was granted. Thereafter petitioners' counsel stated: "I'd like to take exception to particular items" and the court replied (R. 1248): "You may have exception to all instructions that the Court gave." During the colloquy which followed (R. 1248-50) petitioners' counsel made no request to have the

jury excused while the court entertained exceptions or to approach the bench. Nor was the court's attention directed to Rule 30 (supra, p. 3).

After retiring to consider its verdict, the jury was twice recalled to the courtroom for additional instructions, on the second occasion at the instance of petitioners' counsel. (R. 1250-1257.)

ARGUMENT

1. The four petitioner-stockholders contend (Pet. 12-20) that the Government has failed to prove that the unrecorded and unreported receipts which they diverted from the corporation are taxable to them as dividend income, as alleged in the bills of particulars, since the Government failed to establish that the corporation had earnings or profits available for distribution as dividends. This contention ignores the facts of record and is without merit. It is clear from the record that in computing the amounts of unreported income identified in the bills of particulars as dividend income, the Government was guided by the extent of the corporate earnings or profits available for distribution as dividends in each of the fiscal years involved. Moreover, in computing the available earnings for each year, the Government took into account and accrued the additional taxes attributable to the unreported income. As a result, although the proof showed that during the years involved the petitioners had diverted corporate receipts aggregating in excess of $118,000, the amounts of unreported dividend income alleged in the bills of particulars totaled only $111,000, *supra*, pp. 8-9. All the items entering into the Government's computation of unreported dividend income are contained in the ex-

hibits in evidence.[1] (Ex. 1, 64, 68-70.) In short the diverted funds were taxed to the petitioner-stockholders as constructive dividends to the extent of the corporation's available earnings or profits as shown by the evidence. See *Currier* v. *United States,* 166 F. 2d 346 (C. A. 1st); *United States* v. *Augustine,* 185 F. 2d 407 (C. A. 3d), on rehearing remanded on other grounds, 189 F. 2d 587.

Petitioners' assertion (Pet. 17) that the trial court was of the opinion that no earned surplus need be shown is not an accurate reflection of the record (R. 850-954, 896-905, 912-919) which shows that the court had a correct appreciation of the government's theory of the case. Nor did the trial court err, as petitioners contend (Pet. 16-19), in excluding as immaterial and irrelevant the evidence proffered by petitioners which purported to show that the corporation had no earnings available for distribution (R. 1056-1078, 1194-1209). The excluded evidence was offered by petitioners on the theory that in computing earnings or profits for a corporation on an accrual basis, the Government is required to accrue as of the end of each fiscal year amounts which petitioners claim are the deficiencies and civil penalties which the Commissioner of Internal Revenue *proposes* to assess against the corporation, with interest thereon to the date of trial. This novel proposition is without support in authority. Petitioners' reliance upon *Stein*

[1] Petitioners objected to the offer in evidence by the Government of an exhibit (Government's Exhibit 71 for identification) summarizing the data in the various other exhibits relating to the computation, and the court reserved ruling on the offer (R. 854). The Government did not thereafter press for its introduction since the underlying data was already in evidence. Petitioners' statement (Pet. 17) that the court "refused to admit" the exhibit is therefore inaccurate.

v. *Commissioner*, 25 T. C. 940, is misplaced. The *Stein* case was a proceeding before the Tax Court for a redetermination of deficiencies and civil fraud penalties which had been determined by the Commissioner against a closely held corporation and its stockholders. Suffice it to note that here there has been no determination by the Commissioner of the civil tax liability of the corporation for any of the years involved. As the court below noted (Pet. App. 11a-12a), what deficiencies and civil penalties, if any, will ultimately be determined against the corporation is a matter of speculation. It had no place in the trial of these criminal charges, and the court properly excluded the proffered evidence.

Furthermore, even if the rationale of the *Stein* case were to be applied here, it would not aid petitioners in view of the concurrent sentences imposed by the court for the various offenses of which petitioners stand convicted.[2] The decision would not affect their conviction under count one of the indictments charging attempted evasion of their individual income taxes in 1947;[3] nor would it have any bearing on their conviction of the charges of conspiracy and of attempted evasion of the corporation's income taxes. As petitioners recognized (Pet. 13-16) the contention predicated on the *Stein* case relates only to the computation of individual taxes.

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[2] The sentences imposed for the various offenses are to run concurrently with each other and with the sentences imposed for the conspiracy offense.

[3] In *Stein* the Tax Court held that in the case of an accrual basis corporation, the addition to a deficiency for fraud accrues and is deductible in determining earnings or profits, not at the end of the taxable year to which it applies but in the year in which the fraudulent return was filed. Consequently, even under the *Stein* decision, the Government's computation of earnings or profits and dividend income for the first year (1947) would not be disturbed.

2. There is likewise no merit in petitioners' contention (Pet. 27-32) that it was prejudicial error for the court to include in the instructions on intent the language that "the law presumes that every man intends the legitimate consequences of his own acts." The charge on intent (R. 1232, 1239-1241, 1244-1245), as the court below noted (Pet. 15a, 20a), was "unusually full and complete" and gave the jury "the correct legal standard to apply." Under these circumstances, the mere use of the challenged phrase does not constitute reversible error. *Imholte* v. *United States,* 226 F. 2d 585 (C.A. 8th); *Banks* v. *United States,* 223 F. 2d 884 (C. A. 8th); *Legatos* v. *United States,* 222 F. 2d 678 (C. A. 9th); *Bateman* v. *United States,* 212 F. 2d 61 (C. A. 9th). This is particularly true where, as here, it is readily apparent that the challenged language could not have misled the jury to the prejudice of petitioners. Here, the question of wilfulness was largely resolved for the jury if the jury believed, as it evidently did, the testimony of the witness Jensen which clearly implicated petitioners in a conspiracy to evade tax.

The decision below is not, as petitioners assert (Pet. 28-31), in conflict with the decisions of this Court in *Bollenbach* v. *United States,* 326 U.S. 607, and *Morissette* v. *United States,* 342 U.S. 246. Nor is it in conflict with the decisions of the Courts of Appeals in *Wardlaw* v. *United States,* 203 F. 2d 884 (C. A. 5th); *Frank* v. *United States,* 220 F. 2d 559 (C. A. 10th); and *McFarland* v. *United States,* 174 F. 2d 538 (C. A. D. C.). In *Bollenbach,* a prosecution for conspiracy to violate the National Stolen Property Act, this Court struck down a charge (326 U.S. 609) that "possession of stolen property * * * raises a presumption that the

possessor was the thief and transported [the] stolen property in interstate commerce." In the *Morissette* case, the charge condemned by this Court withdrew from the jury the issue of specific intent and was tantamount to a directed verdict of guilty. There was no such vice in the charge in the case at bar. Nor did the challenged language deprive petitioners of their defense, as was true in the *Wardlaw* case. The *Frank* and *McFarland* cases actually support the government's position in that in each instance the court recognized that if the charge as a whole correctly stated the law, the incorrectness of one phrase standing alone ordinarily does not constitute reversible error.

3. Finally, petitioners contend (Pet. 20-27) that, contrary to the provisions of Rule 30, Federal Rules of Criminal Procedure, *supra,* they were denied the opportunity to state fully their objections to the charge out of the hearing of the jury. The contention is without merit. This is not a case in which the court refused to entertain objections to the charge out of the presence of the jury. Petitioners concede (Pet. 21) that counsel did not specifically request an opportunity to state objections to the charge out of the hearing of the jury (R. 1247-1250). This being so they can hardly be heard to complain that the opportunity was denied them.

Petitioners argue, however, that the court should have recognized the colloquy which followed the charge (R. 1247-1250) as a request by counsel to state his exceptions out of the hearing of the jury as contemplated by Rule 30, although counsel did not invite the court's attention to the rule now relied on. The short answer to this argument is that even if counsel's remarks

were to be construed as a request to the court to hear exceptions to the charge out of the presence of the jury, there is no showing that petitioners were prejudiced by the court's failure to regard them as such. In view of the fact that the jury was twice recalled for further instructions, it is apparent, as the court below noted (Pet. App. 14a), that petitioners' counsel had ample opportunity to state any objections to the charge out of the presence of the jury and to request the court to give supplemental instructions in accordance with his view of the applicable law. In fact the record shows (R. 1252-1257) that on the occasion of the second recall of the jury supplemental instructions were given by the court at the instance of petitioners' counsel. Compare, *Schaffer* v. *United States*, 221 F. 2d 17 (C.A. 5th); *United States* v. *Hall*, 200 F. 2d 957 (C.A. 2d). Consequently, even if there was a deviation here from strict compliance with the rule, the error, if any, was harmless. See *United States* v. *Titus*, 221 F. 2d 571 (C.A. 2d); *United States* v. *Hall*, *supra*; *Steinberg* v. *United States*, 162 F. 2d 120 (C.A. 5th), certiorari denied, 332 U.S. 808.

Contrary to petitioners' assertions (Pet. 21-27), the decision of the court below is not in conflict with the decision of this Court in *Escoe* v. *Zerbst*, 295 U.S. 490, which is not in point, nor with the decisions of the Court of Appeals for the Fourth Circuit and the District of Columbia Circuit in *Lovely* v. *United States*, 169 F. 2d 386 (C.A. 4th) and *Butler* v. *United States*, 188 F. 2d 24 (C.A. D.C.). In *Escoe* v. *Zerbst*, *supra*, this Court construed a statute governing the procedure for revocation of parole. In the *Lovely* case, although the court refused to hear exceptions to the charge out of the presence of the jury, the decision was based on other

grounds and the language relied upon by petitioners was *dicta*. In the *Butler* case, the court refused to allow counsel to state for the record his objections to the manner in which the charge was delivered, specifically, the gesticulations and facial expressions of the judge. Here, as already noted, there was no refusal by the court to hear, nor lack of opportunity for counsel to state exceptions to the charge out of the presence of the jury.

CONCLUSION

For the reasons stated, the petition for certiorari should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

October Term, 1955

No. 393

GEORGE BERNSTEIN, ET ALS.,

Petitioners,

versus

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR AN ORDER ENLARGING TIME TO FILE A PETITION FOR REHEARING OR FOR LEAVE TO FILE A PETITION FOR REHEARING

PETITION FOR REHEARING

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PETITION FOR AN ORDER ENLARGING TIME TO FILE A PETITION FOR REHEARING OR FOR LEAVE TO FILE A PETITION FOR REHEARING

To the Supreme Court of the United States or a Justice Thereof:

The petitioners respectfully petition the Supreme Court of the United States for an order enlarging the time within which to file a Petition for Rehearing in the above-entitled and numbered cause, or for an order granting leave to file a Petition for Rehearing, and as grounds therefor show the Court as follows:

1. Accompanying this Petition is a Petition for Re-

hearing in the above-entitled and numbered cause. This Petition is based upon what counsel believe to be intervening circumstances of substantial and controlling effect within Rule 58(2) of this Court.

2. Heretofore, by order of this Court, dated November 19, 1956, the Petition for a Writ of Certiorari was denied.

3. The intervening circumstances upon which the accompanying Petition for Rehearing is based is decision of the Court of Appeals for the Sixth Circuit, rendered on December 3, 1956. It was not until December 13, 1956, that this decision was published in the fastest known reporting service, i.e., Prentice-Hall Federal Tax Report Bulletin, and it was not until December 17, 1956, that said report was available by mail to petitioners' counsel. Counsel allege that by no degree of greater diligence could they have been earlier aware of this decision.

4. In the case of *Clark v. Manufacturers' Trust Co.*, cert. den., 335 U.S. 910 (January 17, 1949), cert. granted, 337 U.S. 953 (June 27, 1949), this Court entertained and granted an untimely Petition for Rehearing. In other cases orders denying certiorari were vacated and the cases were restored to the docket long after the time for rehearing had expired. *Goldbaum v. United States*, cert. denied, 346 U.S. 857 (October 19, 1953); *McFee v. United States*, cert. denied, 347 U.S. 927 (March 15, 1954). Restored to docket 347 U.S. 1007.

5. This Court has held that an opportunity to present a Petition for Rehearing of a denial of certiorari under Rule 58 is a substantial right and is not to be deemed

an empty formality. *Flynn v. United States,* 99 L. Ed. 1298.

Wherefore, the petitioners urge this Court that the interest of justice requires that the accompanying Petition for Rehearing be considered on its merits and that an Order should be made enlarging the time for filing a Petition for Rehearing, or in the alternative the Court should consider said Petition, although filed untimely.

RESPECTFULLY SUBMITTED,

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IN THE

Supreme Court of the United States

October Term, 1955

No. 393

GEORGE BERNSTEIN, et als.,

Petitioners,

versus

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR REHEARING

The petitioners, in accordance with Rule 58(2), of the Rules of the Supreme Court of the United States, respectfully move the Court for a rehearing of the Court's order dated November 19, 1956, denying the petition for a writ of certiorari in the above-entitled and numbered cause, and the petitioners assign the following reasons for the granting of this petition for rehearing.

REASONS FOR GRANTING PETITION FOR REHEARING

I. In the petition for certiorari heretofore filed by the petitioners, the First Question presented for review was as follows:

> Where, by indictment and bill of particulars, petitioners were accused of attempted individual income tax evasion for failure to report certain "dividends", could petitioners be convicted where, under applicable laws, the Government failed to prove the existence (and petitioners were not allowed to show the non-existence) of any accumulated or current earnings or profits of the corporation out of which dividends could be paid?

II. The reasons assigned for granting the writ were in substance and effect as follows:

1. The Government, by indictment and bill of particulars, charged the petitioners with having wilfully attempted to evade their income taxes by failing to report "dividends".

2. "Dividends", reportable as income, are defined by Statute.

   (a) Distributions to a stockholder, out of other than earnings or profits, are not taxable as "dividends".

   (b) To determine availability of taxable "dividends" all federal tax liabilities must first be deducted from net profits.

3. The Government's evidence failed to show that the Selray Corporation had earnings and profits available for distribution as dividends.

4. Petitioners were denied the right to show the Corporation had no earnings or profits out of which to pay "dividends".

5. The Court of Appeals in failing to reverse on this ground is in conflict with the applicable decisions of this Court, and has decided a novel and important question of Federal Law in admitted conflict with the Tax Court of the United States.

III. The rendition of an answer to the above-stated questions was necessarily contained in the decision of the Court of Appeals affirming the conviction of the petitioners, because of the following facts in the case at bar:

(a) The Government by its bill of particulars charged petitioners with having received "dividends" from the Selray Corporation.

(b) The petitioners sought to show that after all taxes and fraud penalties chargable to the Selray Corporation had been deducted from its current earnings or accumulated surplus, that there would be no earnings or profits out of which "dividends", as defined by Statute, might be paid.

(c) The method by which the petitioners attempted to present their individual de-

fenses was by proffering an accountant's testimony and computations showing that after accruing all of the corporation's proposed income tax liabilities and proposed penalties thereto, there were no earnings or profits remaining, and that thus, assuming additional unreported corporate receipts had been received by the petitioners, such funds could not, under the law, be taxable as dividends.

IV. In affirming the conviction of the petitioners, the Court of Appeals held to be correct the various actions of the trial court in denying to the petitioners this defense; and in so holding the Court of Appeals was necessarily required to, and did,[1] squarely reject the decision of the Tax Court of the United States in the case of *Esther M. Stein v. Commissioner*, 25 T.C. 940, whereby it was held that all taxes and fraud penalties must first be deducted from a corporation before a determination could be made of the earnings and profits available for distribution as dividends.

V. Since the denial of the petition for a writ of certiorari in this cause, the Court of Appeals for the Sixth Circuit in the case of *Drybrough v. Commissioner*, ____ F. 2d ____ (C.A. 6, December 3, 1956) (Appendix) has, on facts substantially similar to those of the case at bar, followed

1 "Moreover, it is not consistent with our ideas of proper accounting practice for officers and directors of a corporation to be permitted to conduct the affairs of their corporation in such a way as to defraud the government and then assert the existence of a fraud penalty as a corporate liability, and thus translate what would otherwise be a dividend distribution to themselves into a distribution of capital. If the Tax Court case of Stein v. Commissioner, 25 T.C. 940 holds to the contrary we are not disposed to follow it. * * * " *Bernstein et al. v. United States*, 234 F. 2d 475, 482 (C.A. 5, May 31, 1956).

the rule announced in the *Esther M. Stein* case, supra, that all corporate taxes and fraud penalties must first be deducted from corporate earnings before a determination of profits available as dividends could be made.[2]

VI. The issuance, on December 3, 1956, of the opinion of the Court of Appeals for the Sixth Circuit, in the *Drybrough* case, supra, is an intervening circumstance of substantial effect within the meaning of Rule 58(2), and in accordance with standards promulgated by this Court in *Sanitary Refrigerators Co. v. Winters*, 280 U.S. 30, 34.

VII. The effect of the decision in the aforementioned *Drybrough* case is to create a square conflict between the decisions on the same matter by the Fifth and Sixth Circuits, within the meaning of Rule 19 (1)(b) of the rules of this Court.

VIII. This conflict on this important question and the resulting confusion in the law should be finally determined by this Court. Not only is there the aforementioned square conflict of the Fifth and Sixth Circuits, but a similar question was recently raised in *Davis v. United States*, 226 F. 2d 331 (C.A. 6, 1955), cert. den., 350 U.S. 965 (1956), and will be raised and left unanswered in many cases in which corporate funds are diverted and not reported for income tax purposes. Unless certiorari is

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[2] "We conclude that the earnings and profits available for dividends in each taxable year in issue should be reduced by the deficiencies determined against the corporation for that year. We further conclude that the fraud penalties for which the corporation has been found liable should be deducted from earnings and profits for the respective years in which the fraudulent returns were filed. Estate of Esther M. Stein, 25 T.C. 940, 966-67 (1956); see Dawkins v. Commissioner, ____ F.(2d)_____, (8 Cir., November 5, 1956)." *Drybrough v. Commissioner*, ____ F. 2d_____, (C.A. 6, December 3, 1956).

granted and this issue concluded it appears that there will be an indefinite continuation of a gravely dangerous trend which has already developed (see Appendix ii, Par. 3) whereby different rules for the computation of taxes and taxable income will be applied in civil and criminal cases, although but one set of rules was intended by Congress.

RESPECTFULLY SUBMITTED,

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CERTIFICATE OF GOOD FAITH

I, Arthur B. Cunningham, one of the attorneys for the petitioners herein and a member of the bar of this Court, do hereby certify that the above and foregoing Petition for Rehearing is presented in good faith and not for delay, and I do further certify that the said Petition is restricted to what are believed to be intervening circumstances of substantial or controlling effect.

PROOF OF SERVICE

I, Arthur B. Cunningham, one of the attorneys for George Bernstein, et als., petitioners herein, and a member of the Bar of the Supreme Court of the United States, hereby certify that, on the , day of December, 1956, I served copies of the Petition for Rehearing and copies of the Petition for An Order Enlarging Time To File a Petition For Rehearing or For Leave To File a Petition For Rehearing on the several parties thereto, as follows:

On the United States, by leaving a copy thereof at the office of James L. Guilmartin, Esq., United States Attorney for the Southern District of Florida, Federal Building, Miami, Florida, and by mailing a copy in a duly addressed envelope, with air mail postage prepaid, to the Solicitor General, Department of Justice, Washington 25, D. C.

APPENDIX

F. W. DRYBROUGH v. COMMISSIONER; L. N. SIMPSON v. COMMISSIONER (U. S. Court of Appeals, Sixth Circuit, Nos. 12747; 12748, December 3, 1956)

Before Simons, Chief Judge, Martin and Stewart, Circuit Judges.

Stewart, Circuit Judge:

These are petitions to review decisions of the Tax Court in consolidated proceedings. The facts are set out in detail in that court's findings and opinion. 23 T.C. 1105 (1955) (sub nom. United Mercantile Agencies, Inc.)

Stripped of details, the facts are appallingly simple. The petitioners owned or controlled all the stock of a corporation engaged in the business of conducting a collection and mercantile agency. The corporation and both petitioners kept their books and filed their tax returns on the cash basis. During the years 1942 through 1946 the petitioners systematically removed from the corporation's incoming mail basket checks payable to the corporation, cashed them and divided the proceeds. These secretly diverted funds, amounting to more than $200,000 over the five year period, were not reflected upon the corporation's records or tax returns and were not reported by the petitioners on their individual returns.

Since the appropriated checks represented either fees for collection services or final payments on purchased accounts, the costs of which had been recovered, they constituted income to the corporation and were subject to a ninety-five per cent excess profits tax. The petitioners took the checks in order to evade the payment of this corporate tax.

Their defalcations were brought to light by an internal revenue agent in 1946. The corporation and each of the petitioners were subsequently indicted in the United States District Court for the Western District of Kentucky and jointly charged with knowingly and willfully attempting to defeat the corporation's federal taxes for the years involved. Pleas of nolo contendere were entered, and all three defendants were fined. In addition, both of the petitioners were sentenced to prison. After their release from prison they restored to the corporation the full amount they had taken.

The Commissioner asserted deficiencies and civil fraud penalties of approximately $300,000 against the corporation for failure to report receipt of the diverted funds in its income and excess profits tax returns for the years in which the diversions occurred. The Commissioner further determined that the abstracted funds constituted taxable dividends to the petitioners, and accordingly asserted deficiencies and fraud

penalties of more than $300,000 against them individually. The Tax Court upheld the Commissioner's determinations against the corporation, and no petition for review of that decision has been filed by the corporation. The Tax Court also sustained the Commissioner's determinations of deficiencies and fraud penalties against the petitioners personally, deciding that the funds diverted were taxable as dividends to them (except to the extent that one of the petitioners received such funds attributable to stock belonging to his wife), and that at least part of the deficiencies was due to fraud with intent to evade tax.

On this review the petitioners attack the Tax Court's decisions upon several alternative grounds. They argue that in diverting the corporate funds they were acting merely as officers and agents of the corporation in furthering its criminal purpose of evading its taxes. But if the conclusion be reached that they were acting for their own benefit, they say that they were embezzlers and that the purloined checks were therefore not taxable to them. Commissioner v. Wilcox, 327 U.S. 404 (1946). In any event, they contend that funds which from the beginning were owed to the United States cannot be taxed both as income to the corporation and as dividends to them, particularly where, as here, the amounts were returned in full to the corporation, the deficiencies and penalties assessed against the corporation more than exhausted those funds, and the corporation was thereby rendered insolvent. As to the fraud penalties, the petitioners concede that they were guilty of fraud with respect to the corporation's returns, but maintain that there was no proof of fraud in their personal returns because there was no evidence that they knew they had personally received taxable income when they secretly abstracted checks payable to the corporation.

Before turning to these arguments, it is appropriate to observe that there is not before us in this case any issue as to the petitioners' criminal culpability. It is abundantly clear that the petitioners carried out a deliberate and calculated scheme to cheat their government out of substantial tax revenues at a time when honest taxpayers were called upon to pay levies of unprecedented magnitude; and many citizens were making far greater sacrifices in the waging of a world war. For their criminal conduct they have been punished by fines and imprisonment. Moreover, much more than the full amount abstracted has already been assessed in favor of the government by way of the deficiencies, penalties and interest determined against the corporation. The sole question here is the extent of the petitioners' individual civil liability for taxes and penalties, and the correct resolution of that question will not be promoted by the importation of punitive concepts. The decisions in criminal cases relied on by the respondent are consequently of little assistance in deciding the issue before us. See e.g., Davis v. United States, 226 F.(2d) 331 (6 Cir., 1955), cert. den. 350 U.S. 965 (1956); Currier v. United States, 166 F.(2d) 346 (1 Cir., 1948); Jolly v. United States, 229 F.(2d) 180 (6 Cir., 1956), cert. den. 351 U.S. 963 (1956).

The petitioners contend that since their purpose in taking the corporation's checks was to evade the payment of the corporation's tax, as the Tax Court found, they were merely acting as agents in promoting the fraud of the corporation, owing at all times a duty to hold the funds subject to the demands and needs of the corporation, and that therefore, they cannot be charged with the receipt of income. Cf. Lashells' Estate v. Commissioner, 208 F.(2d) 430 (6 Cir., 1953). This argument is completely specious. Whatever their initial motives may have been, it clearly appears that through the fraudulent transactions in which they were engaged the petitioners received money over which they had complete and unrestricted control, which they took and treated as their own, and for which they doubtless never would have been required to account had it not been for the discovery of their fraud.

Alternatively, the petitioners argue that the funds they received were embezzled by them and therefore did not constitute taxable income under the rule of Commissioner v. Wilcox, 327 U.S. 404 (1946). The petitioners point out that twenty per cent of the common stock of the corporation was owned by the wife of one of them, who did not even learn of the withdrawals until 1947 after their discovery by the internal revenue agent. They further argue that their actions constituted embezzlement under the law of the state where they took place. Reinicke v. Bailey, 33 Ky. L. Rep. 977, 112 S.W. 569 (1908).

How much vitality continues to reside in the Wilcox rule since the Supreme Court's decision in Rutkin v. United States, 343 U.S. 130 (1952) is a question not easy to answer. Compare Kann v. Commissioner, 210 F.(2d) 247 (3 Cir., 1954), cert. den. 347 U.S. 967 (1954) with J. J. Dix, Inc. v. Commissioner, 223 F.(2d) 436 (2 Cir., 1955), cert. den. 350 U.S. 894 (1955).[1] We are convinced in any event that whatever authority the Wilcox rule retains is too narrow to encompass the facts of the present case. The petitioners were not employees who embezzled from an unwitting employer, but officers, directors and stockholders in complete domination and control of their corporation. We think the Tax Court was clearly correct in concluding that the petitioners took the corporation's funds under a claim of right and with the implied consent of the corporation. North American Oil Consolidated v. Burnet, 286 U.S. 417 (1932); United States v. Lewis, 340 U.S. 590 (1951); Rutkin v. United States, 343 U.S. 130 (1952); Healy v. Commissioner, 345 U.S. 278 (1953).[2]

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[1] See "Taxation of Misappropriated Property: The Decline and Incomplete Fall of Wilcox," 62 Yale L. J. 662 (1953).

[2] Both the petitioners testified that they knew that a ninety-five per cent excess profits tax was payable on the funds extracted, and that they therefore thought they were stealing from "Uncle Sam," but the fact is that no tax attributable to any check withdrawn was due at the time it was taken.

Yet, even though received by petitioners under a claim of right, the funds are taxable as dividends only to the extent that the corporation had earnings and profits for the years in which they were withdrawn. Section 115(a) Internal Revenue Code of 1939; Commissioner v. Timkin, 141 F.(2d) 625 (14) 630 (6 Cir., 1944); United States v. Lesoine, 203 F.(2d) 123, 125 (9 Cir., 1953); Charles G. Duffy, 2 T.C. 568, 569 (1943).

The Tax Court held that in determining the earnings and profits available for dividends the corporation's tax liabilities could not be considered, because the corporation kept its books on the cash basis. We are not convinced that the corporation's accounting method requires such a conclusion.

Whether a corporation keeps its accounts and makes its returns on the cash or accrual basis is a question generally relevant only in determining its own income and deductions as a taxpayer. Section 41, Internal Revenue Code of 1939; United States v. Anderson, 269 U.S. 423 (1926); Spring City Foundry Co. v. Commissioner, 292 U.S. 182 (1934); Ohmer Register Co. v. Commissioner, 131 F.(2d) 682 (6 Cir., 1932). Moreover, when that is the determination to be made, the question of federal income taxes does not arise, whether the taxpayer is on the cash or accrual basis, because such taxes are generally not deductible.[3]

Here the question is obviously quite different. It has been recognized that when it becomes necessary to determine the amount of a corporation's earnings and profits in order to determine the character of distributions to a shareholder, the usual principles as to accruability do not apply. For example, in determining its own net income, taxes cannot be deducted by an accrual basis corporation if they are disputed or denied. Security Flour Mills Co. v. Commissioner, 321 U.S. 281 (1944) (federal processing tax); Dixie Pine Products Co. v. Commissioner, 320 U.S. 516 (1944) (state gasoline tax). Yet, in determining the amount of such a corporation's earnings and profits, the Tax Court has not hesitated to recognize a different principle. Estate of Esther M. Stein, 25 T.C. 940, 965-67 (1956); Stern Brothers & Co., 16 T.C. 295, 322-23 (1951). In both those cases the court reduced the amount of earnings and profits by the amount of disputed federal income taxes in order to arrive at the corporation's true financial status.

In analogous situations courts have refused to distinguish between cash and accrual basis corporations where it would be unrealistic to do so. Thus a cash basis personal holding company can deduct accrued but unpaid federal income taxes from its personal holding company income

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3 Although they are of course material for such purposes as excess profits and personal holding company taxes. See discussion below.

although § 505(a)(1) Internal Revenue Code of 1939 provides for deduction of "taxes paid or accrued during the taxable year." Birmingham v. Loetscher Co., 188 F.(2d) 78 (8 Cir., 1951); Aramo-Stiftung v. Commissioner, 172 F.(2d) 896 (2 Cir., 1949); Commissioner v. Clarion Oil Co., 148 F.(2d) 671 (D.C. Cir., 1945), cert. den. 325 U.S. 881 (1945); Wm. J. Lemp Brewing Company, 18 T.C. 586, 600 (1952). A similar result has been reached in applying the § 102 penalty surtax. Harry M. Stevens, Inc. v. Johnson, 115 F. Supp. 310 (S.D. N.Y., 1953). Moreover for the purpose of asserting transferee liability, corporate insolvency in the year of the transfer has been established by deducting tax liability which was unknown at the time of the transfer and was not assessed until a later year. Vestal v. Commissioner, 152 F.(2d) 132, 134 (D.C. Cir., 1945); Scott v. Commissioner, 117 F.(2d) 36 (8 Cir., 1941).

In M. H. Alworth Trust, 46 B.T.A. 1045 (1942) the question for decision was substantially the same as that presented here, although it arose in a quite different context. The conclusion of the Board of Tax Appeals was expressed in the following language:

> "To permit the distribution of gross earnings and profits without making allowance for outstanding obligations would leave such obligations as a charge on capital regardless of the method by which the corporation keeps its books and reports its income for Federal income tax purposes, and any method of accounting which reflects an amount of earnings and profits as being available for distribution as dividends in excess of net earnings and profits actually existing must under general corporation law give way to realities and can not control. We think it follows that in determining gains or profits available for distribution as dividends, as the term 'dividend' is generally defined, accrued but unpaid taxes must be taken into account." 46 B.T.A. 1047.

This decision was reversed in Helvering v. Alworth Trust, 136 F.(2d) 812 (8 Cir., 1943), and the respondent here relies on that opinion. See also Paulina duPont Dean, 9 T.C. 256, 266-67 (1947). The practical issue presented to the Court of Appeals in the Alworth case, however, was whether corporate tax liability should reduce earnings and profits in 1937 or 1938. Here, by contrast, the practical issue is whether a corporation's earnings and profits can ever be effectively adjusted by taxes owed and subsequently paid, in order to prevent a distribution of capital from being taxed as ordinary income. In resolving that issue we are persuaded by the reasoning of the Board of Tax Appeals in the Alworth case.

Nothing in Healy v. Commissioner, 345 U.S. 278 (1953) implies a contrary result. There taxpayers who had received salaries from closely held corporations had been required in a later year as transferees

to pay tax deficiencies assessed against their corporations because part of their salaries had been held to be unreasonable and therefore not deductible by the corporations. The Court held that their incomes were to be adjusted in the year of payment of transferee liability, not in the year the salaries were originally received. No question of earnings and profits was involved.[4]

In the present case the petitioners knew that the corporation was properly chargeable with a ninety-five per cent excess profits tax on the funds which they were diverting. They subsequently had to pay the money back to the corporation to enable it to meet its tax obligations. Both common sense and realism require the conclusion that the corporate taxes attributable to the diverted income should be excluded from the corporation's earnings and profits under the circumstances of this case: We conclude that the earnings and profits available for dividends in each taxable year in issue should be reduced by the deficiencies determined against the corporation for that year. We further conclude that the fraud penalties for which the corporation has been found liable should be deducted from earnings and profits for the respective years in which the fraudulent returns were filed. Estate of Esther M. Stein, 25 T.C. 940, 966-67 (1956); see Dawkins v. Commissioner, . . . F. (2d) . . . (8 Cir., November 5, 1956). To the extent of earnings and profits thus determined the diverted funds will be taxed to petitioners as ordinary income in the years received. Withdrawals in excess of earnings and profits will be taxed as capital gains after the adjusted basis of petitioners' stock has been exhausted. Sections 115(a), 115(d) Internal Revenue Code of 1939.[5]

There remains only the question of the petitioners' fraud with respect to their individual returns. As to that we are convinced the Tax Court's findings are correct. By their own admission the petitioners knew that even if they had filed honest returns on behalf of the corporation they would have been subject to individual tax liability on at least five per cent of their withdrawals. Yet they did not report any of the diverted funds in their tax returns. Only part of a deficiency need be shown to be due to fraud with intent to evade tax in order to

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[4] Similarly, in Bennett E. Myers, 21 T.C. 331, 346 (1953) fictitious salaries were involved. In Eugene Vassallo, 23 T.C. 656,-662-63 (1955) the question of the corporation's earnings and profits were not discusssd.

[5] Whether and to what extent petitioners are entitled to deductions for the year 1951 when they paid the funds back to the corporation are questions not now before us. See Healy v. Commissioner, 345 U.S. 278 (1953); Arrowsmith v. Commissioner, 344 U.S. 6 (1952); Crellin's Estate v. Commissioner, 203 F.(2d) 812 (9 Cir., 1953). If no such deductions have been claimed, the statute of limitations would now seem to be a formidable impediment. See cases collected in Mertens Law of Federal Income Taxation, Section 58.39.

invoke a civil fraud penalty. Section 293(b) Internal Revenue Code of 1939. The petitioners must therefore pay fraud penalties on the deficiencies which will be found due on remand to the Tax Court.

The decisions of the Tax Court are set aside and the cases are remanded for proceedings consistent with the views expressed in this opinion.